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PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL
(Grace Commission)

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BEFORE THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

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PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL

(Grace Commission)

MONDAY, NOVEMBER 7, 1983

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The committee met, pursuant to notice, at 9:37 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Armstrong, Symms, Quayle, Gorton, Chiles, and Metzenbaum.

Staff present: Stephen Bell, staff director; Gail Fosler, chief economist; Richard N. Brandon, minority staff director; and Garry Schinasi, senior economist for the minority.

Chairman DOMENICI. The hearing will come to order.

I understand some other Senators are en route. Normally, I would wait a little longer but I think a number of Senators are going to have conflicts in their schedules. I personally have a very unfortunate situation. I have to leave at 10 o'clock for a funeral in Rockville so I want to get started, and we will arrange to have somebody chair the meetings for the rest of the morning.

I understand Senator Chiles will be here shortly, and Senator Armstrong is en route.

OPENING STATEMENT OF CHAIRMAN DOMENICI

I welcome to our committee this morning, you, Mr. Grace, Chairman of the President's Private Sector Survey on Cost Control. Indeed, this project is often referred to as the Grace Commission after you, Mr. Grace, its chairman.

I would also like to welcome Mr. Larkin, Mr. Bolduc, and Mr. Gish, all of whom, I understand, are prepared to answer questions about the project's recommendations. Is that correct?

Mr. GRACE. Yes, sir.

RECOMMENDATIONS FOR REDUCING FEDERAL SPENDING

Chairman DOMENICI. The President's Private Sector Survey on Cost Control contains broad-ranging proposals for reducing Federal spending. These recommendations will certainly be important to the upcoming budget debates in this committee. The purpose of this hearing this morning is to begin exploring the recommendations.

The Grace Commission report is voluminous. It consists of 37 task force reports on subjects ranging from financial asset management practices to the operation of the Office of the Secretary of Defense. It was commissioned by President Reagan in June 1982, and I understand contains more than 2,200 savings and revenue enhancement recommendations. According to the Commission documents, adoption of these recommendations could result in nearly $300 billion in savings over a 3-year period. Further, the Commission estimates that about half of these savings could be achieved under existing authorities, and, therefore, require no congressional action.

Welcome, Senator Armstrong.

SAVINGS ESTIMATES DESERVE CAREFUL CONSIDERATION

Such large savings estimates deserve careful consideration by the Congress and the executive branch. I understand the Office of Management and Budget has begun an internal review of the Grace Commission recommendations. I believe it is fair to conclude that the Office of Management and Budget review will probably be reflected in the administration's fiscal year 1985 budget submission.

The Senate Budget Committee has begun its own internal review beginning with hearings today. In addition, over the next 2 months this committee staff and other congressional staff will be meeting with managers of specific task force reports. These meetings will focus on recommendations in the defense, human resources, procurement, accounting, and operational areas. The committee intends to review as many of the task force recommendations as possible; establish estimates for budget savings; and identify recommendations that could be implemented either under existing statutes or under statutes that require new legislation.

Further, Senator Chiles and I will request shortly a detailed—good morning, Senator Chiles—a detailed evaluation of the Grace Commission recommendations from both the CBO and the General Accounting Office. Both organizations will report back to us early next year in time for our annual budget deliberations.

Later this morning, Dr. Rudolph Penner will provide the committee with a preliminary CBO overview of the Grace Commission recommendations. This will be Dr. Penner's first appearance before the Senate Budget Committee in his official capacity as the new Director of the Congressional Budget Office.

We look forward to your testimony this morning, and Senator Chiles, might I indicate I started about two minutes ago, and that I have to leave at 10 o'clock, and I thought we might hear the opening statements and some testimony before I left. I would be pleased to yield now to you, Senator Chiles.

OPENING STATEMENT OF SENATOR CHILES

Senator Chiles. Thank you, Mr. Chairman. I welcome our panelists this morning to report on the findings of the Grace Commission. I know that this study is the work of many months and many minds, all centered upon what can be done to streamline government, and while we are trying to make it more efficient, also to make it less costly.

BETTER ADMINISTRATIVE PRACTICES NEEDED

After some preliminary staff review, it seems to me that the report has to be approached on two angles. First, I recall the President's early enthusiasm for balancing the budget with management savings to beat down the three racketeers of fraud, waste, and abuse, and frankly, I do not see how anyone could oppose improvements in these areas.

To the extent that your recommendations focus on the need for better administrative practices, certainly you find me and I think this committee willing allies and listeners. We always look for ways to provide necessary service at the lowest cost in the most timely way, and I will support this President as I would support any President designed to get the most for the taxpayer's dollar.

CONTROVERSIAL LEGISLATION REQUIRED TO ACHIEVE SAVINGS

From another perspective, however, I find that the Commission identifies many areas of savings that cannot be achieved by executive inhouse adjustments alone. The Commission study includes a long list of savings which, although are within the responsibility of the Commission mandate, are outside the capacity of the executive branch to achieve on its own.

To cite a few examples, in the area of veterans health, the Commission finds possible savings amounting to $11.4 billion over 3 years. A fourth of those savings would have to come as a result of major policy changes on veterans entitlements.

Moreover, the Commission recommends stopping construction of all VA hospitals and using private firms to operate VA health care facilities. That sort of savings would, no doubt, generate a great deal of debate in the Congress.

In the wider area of health care administered by the Department of Health and Human Services, 82 percent of the $14.4 billion that the Commission says could be saved in 3 years would require controversial legislation.

For example, the Commission recommends establishment of negotiated fee schedules for physicians under medicare with a savings of $3.3 billion over 3 years. As it happens, there has been considerable debate over a much more modest version of this issue in the House of Representatives this year, and at this time, it looks like that proposal is headed for failure.

Of the recommended savings under the Department of Interior, 90 percent would require policy and legislative change. Finally, the Commission finds that nearly $1.9 billion could be saved by improving income eligibility verification of HUD program recipients, and while it is true that as much as 12 to 17 percent of the current recipients may be ineligible, those households would be replaced by new ones since more households are currently eligible than are currently being served.

I do not point to these examples as criticisms of the study. The study itself is a useful inventory of how savings can be achieved and how the Federal deficit can be reduced. But the key is that we must be careful not to overestimate what can be saved or overdefine what we mean by management savings.

The popular notion of management savings is that they are somehow easier to make and somehow in a category outside the reach of national debate that somehow they can all be achieved with a memo rather than by an act of Congress.

These Commission findings constitute another agenda for reform which is neither easier to achieve nor detached from legislative review.

I certainly welcome your report and I expect the Congress to cite it over and over as we continue to work toward executive government service in which necessary service is not victimized by bad management.

Chairman DOMENICI. Thank you very much, Senator Chiles.

Senator Symms.

OPENING STATEMENT OF SENATOR SYMMS

Senator SYMMS. Thank you very much, Mr. Chairman, Mr. Grace, and distinguished members of the panel. I want to welcome all of you to the committee this morning, and as I said earlier, when you see some of us get up and file out, there are three or four of us here that have a markup just downstairs in the Finance Committee that is going to start a little later.

But I just want to make a couple of points, and then I have one question I would hope that you could address, and I hope I can still be here when you do.

INCREASED TAXES NO SOLUTION TO PROBLEMS

First, I want to compliment you for your efforts on behalf of the President and the country in the entire apparatus and work of the Grace Commission. Over in the House Budget Committee, Mr. Grace said that any attempt to balance the budget by raising taxes would put rates at an unprecedented high level, beyond the ability of families to absorb, and second, he said most of the increases in the Federal outlays since 1948 result from the growth in the Government's transfer payments, up 45 times from $9.1 billion in 1948 to $108 billion in 1983.

Actually, he made the point that if the Government were to confiscate all income above $75,000 it would only run the Government for 14 days. So I think we clearly recognize that the solution to our budgetary problems is not increased taxes but addressing structural reforms and the transfer payments, or, as they are popularly known, the entitlement programs.

JUSTIFICATION FOR SPENDING REDUCTIONS

The Grace Commission's findings of over $300 billion cost savings over the next 3 years certainly defy those who claim that the President's budgets have stripped programs to the bone and we are now left to cutting muscle rather than fat out of the bureaucracy.

Of course, some of those recommendations are not new, but that does not mean that they are not worthy of serious consideration. With Government spending representing 26.3 percent of the total U.S. economic activity in the fourth quarter of last year and threatening to grow even larger unless we can put on some restraints, there is justification for sizable spending reductions, and as Mr. Grace has pointed out, these savings could be achieved without impairing our badly needed defense modernization program or without harm to the Nation's poor or the needy.

For too long the efficient functioning of the Government has been constrained by politicians who have failed to understand simple good business practices and procedures, and who refuse to allow the private sector the chance to assume Government functions, although they could perform these services more effectively.

Again, I want to thank all of you for your efforts and for the work of the task force, and I would just make one further comment, Mr. Chairman. As one Senator, I have never been one who really wanted to work too hard to make Government efficient, but I would rather just reduce it or when possible, abolish it and turn those programs over to the private sector. I think that by the nature of Government, it is not designed to really be efficient.

I often made the statement that if we got all the Government we paid for, we would have the private sector completely put out of business, so it is probably good in some areas that our regulators are not efficient or they would have everybody out of business.

TRAGIC IF COMMISSION EFFORTS GO DOWN DRAIN

But I just want to say to the members of the panel here that I think that it would be tragic if all of the efforts of the Grace Commission just go down the drain like the Hoover Commission did. In light of that, I have enlisted the support of a gentleman in my State who is a sometime journalist but primarily a businessman. He made the comment to me that the Grace Commission probably will be just like the Hoover Commission, that nothing will come of it because you fellows in Washington will listen to it, and then go on about your business.

Consequently, I have enlisted Mr. Ralph Sneed to come back and coordinate some efforts on my staff through the Joint Economic Committee, to try to see whether we can privatize some Government functions, or at least not let the Grace Commission report go on deaf ears.

I would hope we could have some cooperation with you and the Commission to try to see that this effort is followed through, and urge a coordinated effort between the Joint Economic Committee and the Budget Committee to share all that information with our colleagues on the authorizing committees that will have to act on it. This issue should not be something that was merely labeled a good report, and then dispensed with. You have pointed out so many things that we could do, and I think there are some exciting possibilities if we could make some coordinating efforts.

The Heritage Foundation also has offered to give a lot of support, Mr. Chairman, to staff work for all of us on both sides of the aisle, if we are interested in trying to help us bring about some realities from this effort. I appreciate you, Mr. Chairman, having this Commission here to testify, and you certainly have my support to try to put some of these proposals into effect. We are going to try to work very hard to work with all Senators to see that this information becomes available. Thank you.

Chairman DOMENICI. Thank you, Senator Symms.

Senator Armstrong, do you desire to make an opening statement?

OPENING STATEMENT OF SENATOR ARMSTRONG

Senator **Armstrong**. Mr. Chairman, I really do not have a lengthy statement other than to congratulate you on holding these hearings. I am eager to hear the testimony of Mr. Grace. I acknowledge that what my colleague, Senator Symms, has said about the possibility, Mr. Grace, that your report will gather dust on the shelf, that that is probably right, but if I were sure it was right, I would not have come this morning.

I think there is at least a reasonable chance that maybe we can take some of these recommendations and do something with them. Senator Chiles is correct, I believe, in saying that it will require controversial legislation, but most of the things that are worth doing around here have an element of controversy to them.

Somebody at some point in time this morning or on some occasion when we get around to voting on some of the recommendations in your package is going to say, "Well, this will be very difficult to implement," and that is certainly true, but I can tell you that there is, at least on the part of many of us, a renewed interest in getting this thing back on the rails and a sense that the report which you have produced is a very valuable contribution to the thought life of our country, and so I am looking forward to the testimony, Mr. Chairman, and eager to see how much of this we actually can enact into law.

Chairman **Domenici**. Thank you very much, Senator.

Senator Gorton.

Senator **Gorton**. Thank you, Mr. Chairman. I have no statement. I am eager to hear what these gentlemen have to say.

Chairman **Domenici**. I have a statement I would like to insert into the record at this time from Senator Hatch who is unable to be here today.

[The following was received for the record:]

Statement of Senator Hatch

Gentlemen, I appreciate your appearance before the Budget Committee this morning. The task you are concerned with, controlling the cost of government, is an extremely important and urgent one. Cutting wasteful and unnecessary Federal spending and reducing this burden on our economy is the only way to reduce deficits.

In 1980, Federal spending equaled 23 percent of our national product. Even with the Reagan administration's determined attempts to restrain it, some estimates are that Federal spending will have consumed 25 percent of GNP in fiscal 1983. Your estimate, I believe, is as high as 26 percent. Unfortunately, the future does not look too much brighter, particularly if Congress continues to give President Reagan only about 50 percent of the cuts in Federal spending which he requests. All that we do with this excessive Federal spending is to create and encourage special interest groups with spending programs which grow faster than the economy which is expected to support them.

I am pleased to note also that you, too, are concerned with the explosive growth of open-ended spending or "entitlement" programs. Approximately 78 percent of Federal outlays each year are expended on such programs. We must accomplish a reasonable and responsible reform of these programs and, as your report notes, put them on a sounder financial basis. Only in this way will the Federal Government in the future be able to keep the promises it now makes to veterans, to retired Federal employees, and other worthy groups.

Besides reform of the entitlement programs, which is a responsibility Congress will have to face, many of the ways to cut Federal spending which you recommend are management initiatives. I congratulate you on your efforts and am eager to hear your suggestions about how Congress can best help achieve this reduction in Federal spending.

ASSUMED SAVINGS DO NOT ALWAYS OCCUR

Chairman DOMENICI. Let me say to you, Chairman Grace, and members in attendance with him, that one of the difficult problems this committee has, as a Budget Committee, is that we can assume savings and then find that they are not going to take place. We do this through the tool called reconciliation where we order committees in a general way to reduce expenditure levels within their committees. We have been burned a couple of times in that regard, and I think your study group is aware that we have plugged in administrative savings and management savings in very large amounts only to find that they did not occur.

Therefore, the resolution encompassing and encapsulating the Government becomes less and less credible. I understand that you do not maintain that your recommendations are easy nor do you maintain that they all can be made by a President. A Congress has to do a lot of the things that you recommend and quite appropriately describe here as very controversial in some respects.

Nonetheless, I think it is a tremendously valuable thing to have. I hope we can do it a little bit of justice by moving it along so that others get interested in it. It must get very, very widespread understanding among the committees here for it to really be an effective tool. I certainly compliment you for your willingness to spend time trying to get people to understand it, to spread it around so that committees may see where their responsibility to consider pieces of it lie. Perhaps then, they will step up to the table and take a little bit off here and there.

So with that, we welcome you. Your remarks have been made available. They will be made a part of the record as if read.[1] You may proceed.

STATEMENT OF J. PETER GRACE, CHAIRMAN, PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL, AND CHAIRMAN AND CHIEF EXECUTIVE OFFICER, W. R. GRACE & CO., ACCOMPANIED BY FELIX E. LARKIN, MEMBER, EXECUTIVE COMMITTEE, AND ASSOCIATE, W. R. GRACE & CO.; J. P. BOLDUC, CHIEF OPERATING OFFICER, SURVEY'S MANAGEMENT OFFICE; AND J. GISH, STAFF, W. R. GRACE & CO.

Mr. GRACE. I think I should summarize them, Senator, because I might run over my time. I will not identify myself and all of that. That is all done.

We are going to summarize what is likely to result if the Government's current financial situation is not corrected. We are going to provide an overview of what the President's Private Sector Survey has found in savings and revenue enhancement. We are going to discuss specific examples of savings and revenue opportunities, and one last point would be why we are convinced that the time for action is now and why these recommendations can serve as the vehicle to effect meaningful improvement in the management of the Government's business while, at the same time, realizing substantial reductions in cost and increases in revenue.

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[1] See p. 21.

RECORD OF REVENUES, OUTLAYS, AND DEFICITS

Now, we have a little set of charts,[1] and I am informed that each one of you have separately these charts, and I will go through them very quickly. It just shows the record of the revenues, the outlays and the deficits 1965, 1975, 1983, which, of course, you are very familiar with, much more than I am.

It just shows three extrapolated rates on the 1965-1983 rate of revenues and outlays, 1975-1983, and then, if you bring them together, instead of growing them at 1.7 percentage points or 2 percentage points difference as they have, the outlays have grown almost always historically a little faster than revenue.

If you bring them together, then the deficit in 1990 would be $381 billion and $987 billion in the year 2000. If you do not bring them together, if you keep them going at these differential rates, it will be $539 billion in 1990 and $2 trillion in 2000. And at the 1975-1983 rate, it would be $571 billion in 1990, and $2.3 trillion in the year 2000.

DRI "STATUS QUO" PROJECTIONS

The next chart.[2] We hired Data Resources, DRI, in the PPSSCC effort to take a lot of the social programs—there are 962 different social programs, and as you know, they are formularized in the Congress, so that if something happens like people getting older or something, certain other things automatically happen.

What we have done is run through a very large computer program to show under different assumptions what will happen. Now, they come out with, on a status quo basis, and we have other assumptions, with $386 billion deficit in 1990 and $2.038 trillion in the year 2000.

That is just the first cut at the study, and it is going to be in the President's report.

FAMILY TAXES

Now, referring to what Senator Symms said about taxes, the third chart[3] shows four different income families, $20,000, $30,000, $40,000, and $50,000 on a gross-income basis. Now, that would be about a quarter of that in 1948 dollars. So these are not wealthy people.

And, very amazing, and we do not find too much understanding of this that, for instance, $20,000 is the first column. That is a taxable income of $11,400. So it is no big deal. But 63 percent of the total cumulative, personal-income-tax flow has come through that level. At $11,400, you have captured 63 percent of the flow, and at $40,000, you have captured 87 percent of it.

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[1] See p. 23.
[2] See p. 26.
[3] See p. 28.

Now, their tax rates, these people, taking social security and income taxes, have gone from 5.1 percent, the $20,000 gross, $11,400 taxable, from 5.1 to 16 percent in 1981. Then it came back to 14.9 percent.

Now, this caused a discretionary after-tax income drop in constant 1983 dollar—in 1948, they had $7,266, dropping to $5,237. Across that whole line, line 11, you will see drops of about 28 percent in the discretionary personal spendable income of these families, and then they got a small increase of 1.4 to 2 percent out of the so-called Reagan tax cut.

So we do not feel that there is very much room to close these deficits——

Senator **ARMSTRONG**. Mr. Grace, forgive me. I think that your familiarity with these figures causes you to go through them so fast that we are having difficulty following them.

Mr. **GRACE**. I will go much slower, Senator.

DISCRETIONARY AFTERTAX INCOME

Senator **ARMSTRONG**. Maybe my colleagues have reviewed this in advance. I have not had an opportunity to. With the chairman's indulgence, could we go back to the issue of the discretionary aftertax income? Would you take us back through that again so that we may understand it?

Mr. **GRACE**. Yes, sir. I am very sorry. I apologize. The last thing in the world I want to do is not communicate properly.

Senator **ARMSTRONG**. I appreciate that. You have been thinking about the numbers, and we are still in shell shock when we look at this.

Mr. **GRACE**. Just looking at the four gross incomes, $20,000, $30,000, $40,000, and $50,000, and as I pointed out, the $20,000 is a taxable income of $11,400, and the $20,000 gross is equivalent to a gross income in 1948 of $4,800. So the first column there of $20,000 is $4,800 gross in 1948. In other words, it is about a quarter of those figures in 1948 dollars. And the taxable portion of the $20,000 is $11,400.

Now, as you know, the family of four or three or two have personal exemptions which, by the way, have not been indexed. They were $600, and now they are $1,000. It was $600 in 1948. Had the personal exemption for these families been indexed, we would collect $53 billion less. The $286 billion would drop down to about $233 billion.

But anyway, now, these tax rates, what we have done is looking at the total income and social security taxes paid by these three levels of growth income where the taxable income is about 60 or 70 percent of that figure, and the first point is that if you take the river like the Mississippi River of personal income tax flow and you put a ruler at $20,000 gross or $11,400 taxable, what percent of that river have you caught? Well, now you caught 63 percent at that point.

As Senator Symms said earlier, when I said you would run the Government 14 days if it took every thing over $75,000, that is correct. The reason for that is the fact that 63 percent of the flow is below $11,400 taxable or $20,000.

Now, that 14 days that Senator Symms mentioned would be correct if the people kept on working and doing everything they were doing previously once they found out that everything over $75,000 went to the Government. I doubt they would continue very long on that basis.

AVERAGE TAX RATE

But now, getting down to the rate, the average tax rate of that $20,000 gross when it was $4,800 in 1948 was 5.1 percent income and social security. Now the tax rate through 1981 went from 5.1 percent in column 1, line 5 to 16 percent in line 6 in 1981; 7.7 to 18.7 percent for the $30,000 gross; 9.3 to 20.1 percent for the $40,000 gross; and 10.4 to 21.4 percent in the $50,000 gross.

Now, the so-called Reagan tax cut took those rates back from 16 to 14.9 percent, 18.7 to 17.3 percent, 20.1 to 18.8 percent, and 21.4 to 19.9 percent. Now, then, what we did was to take the discretionary aftertax income and look at it in terms of 1983 constant dollars——

DISCRETIONARY INCOME IS AFTER FAMILY ESSENTIALS

Senator **Armstrong**. Before you continue, could you just illuminate the term,"discretionary"?

Mr. **Grace**. Yes, sir, the discretionary income is after the essentials that the families have to pay for food, rent, et cetera. Now, Mr. Kamsky is here.

Senator **Armstrong**. In other words, it is not just aftertax income but after some other items?

Mr. **Grace**. Yes, sir.

What items?

Mr. **Kamsky**. This is after necessities of food, shelter, clothing, utilities. It excludes things like eating out, vacations, and the like.

Mr. **Grace**. What people have really after they have the essentials of their living, Senator.

So anyway, we see here that there has been a major drop of around 28 percent in the discretionary family income through 1981 with a small 1.5 to 2 percentage point increase back again under the Reagan tax cuts, and this has been shown, Senator, in a number of studies that are out that there has been a small increase back in the discretionary income.

Is that explanation satisfactory?

TAX EXPENDITURES

Senator **Chiles**. I just wonder if you might just illuminate for me a little bit more. In the rates that we are looking at here, of the total cumulative income captured at each bracket, is that including tax expenditures and the provisions like that or not?

Mr. **Grace**. No. Let us put it this way, Senator. That flow of taxable income obviously is controlled by what are tax expenditures. If you gentlemen eliminate the deductibility of interest on home mortgages, then that taxable flow, obviously, becomes larger because that is a new element that becomes taxable.

This is the taxable flow under the present system of what is taxable. There is $156 billion, as you know, Senator, of additional so-called tax expenditures in quotes, and if they are added back, then the taxable flow will, of course, be larger.

But under the present taxable flow with the present taxable elements, 63 percent of the total flow, that includes, Senator, your income and my income at that level. In other words, it is the cumulative amount running through that level.

Senator CHILES. The reason I was asking that is that that has been one of the largest growth factors that we have had since 1948 is the so-called taxable expenditures, too. So that certainly affects how we are looking at this river.

Mr. GRACE. I do not think it does, Senator, because there has always been the deductible. Most of the largest of the tax expenditures are traditional. They go back to 1913, 1920. They go way back. Deductibility of charitable contributions, home mortgages, et cetera.

We have made a complete study of the $156 billion of taxable expenditures, and we have studied it by bracket. In other words, if you do this and that, what brackets get hit the hardest, and we find, except for tax-exempt interest on bonds that are issued by the communities around this country, and as you know, they have been carried pretty far when you even get a McDonald's built under a tax-exempt bond. That is another issue.

Except for that, the bulk of the income hit is in the $35,000 to $40,000 level on most of those $156 billion of tax expenditures. But actually most of these tax expenditures have been traditional with the system.

So when you compare 1948 to today, basically it has traditionally been that the bulk of the taxable income is in the lower income bracket, and that is just where it is. When we mention this, we used to say there was a robber in New York by the name of Willie Sutton and he always robbed the banks. They said, "Why do you always rob the banks?" He said, "That is where the money is."

Now, this is where the money is in the tax flow, and if you bring in these $156 billion of tax expenditures, you will find most of them also flow into the $25,000 to $40,000 income group, when you bring it cumulative, except for the tax exempt bond interest.

So this is where the money is, and I am not trying to get into politics at all, but that is when a politician of any party that says that we can get more money by taxing the rich, you can, but it is peanuts. That is exactly where it is.

TAXABLE INCOME AND TAXES GENERATED FROM ALL TAXPAYERS

Now, I will move to the next chart[1] if I might with the permission of you gentlemen, and this shows more or less the same thing, because it shows the dollar amount left in columns 5 and 6 of taxable income and taxes paid.

You will see that the cumulative taxable income is 90 percent that comes through the bracket $30,000 to $35,000. There is 90 percent of the bracket of the taxable income; 87.5 percent comes through $25,000 to $30,000. That is line 4 and line 5.

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[1] See p. 30.

Now, how much money is left as you get down the list? Well, you have got $16 billion of taxable income in the bracket $100,000 to $150,000. You have 25 in the $75,000 to $100,000, and $50,000 to $75,000 you have 33. That is the total amount of income left after you get through the top numbers.

In those brackets, that is the total amount left. If you take it all, you would get the total amount shown in column 5.

Is it all right to move forward now? Thank you.

CUMULATIVE IMPACT OF COMMISSION SAVINGS

Now, the next chart,[1] and I think this is a very interesting chart, and it surprised me greatly when we prepared these numbers. When the government decides today to spend another dollar, it is going to borrow that dollar and it is going to put it into the system, and it will be inflated by the inflation as we go along in the future.

Now, let us say for the moment that we are having argument amongst us and we say that you should save $100 and you gentlemen decide we will not save the $100. In this case it is $100 billion, because our annual savings amount to $100 billion. So let us say they are not done or they are done. In other words, we say they should be, and the Congress says, no.

Fine. We go back to work and thank you very much for your attention, and then we say, what is the effect, cumulative effect of the Congress having said no to us, and you will see in column 2 and column 4 what the cumulative effect is.

Now, $100 billion in 6 years, it is $921 billion if the inflation rate is 5 percent and interest is 10 percent. And as you know, the Federal Government is already paying overall more than 10 percent interest, and the inflation rate could move above 5.

The other column shows a 10-percent inflation rate and 15 percent interest. We think that is that parameter of the possibilities; 5-percent inflation, 10-percent interest or 10-percent inflation, 15-percent interest.

Now, if you have in 6 years suffered 10-percent inflation and 15-percent interest, then the number becomes 12 times, $1.2 trillion; for every $100 billion that is not saved, the cumulative cost is $1.2 trillion.

Now, when you move out 12 years, it is 29 times in the 5-percent inflation example and 51 times in the 10-percent inflation example. So in other words, net net net, if when we give our report to the President, we have $100 billion of unduplicated savings, and we are going to be over $100 billion.

Senators, if you do them, you will save $2.9 trillion to $5.1 trillion over 12 years. If you do not, that is going to be the additional cost of not doing it. It is just as simple as that; 29 to 51 times over 12 years.

Now, these are mathematically correct. Anybody can take a hand calculator with a compound interest factor and see, because when you are borrowing every nickel of additional money you spend, and there is an inflation situation, that is what it works out at.

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[1] See p. 32.

Can I move forward to the next chart? Senator Symms, there is a chart there that I have not shown before. If you could look at the chart which is page 12 of my prepared statement—do you have the separate charts there? The last chart shows, if you could look at that last chart to show net that in six years whatever savings are made or not made, represents 9 to 12 times the amount. In other words, if we recommend $100 billion and the Congress says, no, we will not do any of it, fine, then that is $900 billion to 1.2 trillion in six years, and it is $2.9 trillion to $5.1 trillion in 12 years. That is the net net of it.

THE FEDERAL GOVERNMENT AND BUSINESS MANAGEMENT

Now, the final chart [1] that we have here, some people have questioned whether the President should have asked a bunch of businessmen down here who do not know anything about government, they are just a bunch of people who run organizations to make money, you know, filthy lucre, why he should bring them down here.

Well, the only thing we wanted to say that what is common between business and government. You have procurement. Business is constantly involved in procurement. That was $20 billion in 1960. It is $160 billion now, and there is assurance of the state-of-the-art equipment, competitive bidding, dual sourcing, inventory control and warehousing and distribution.

Personnel. We all have to manage and in our company, we have 80,000 people so we have big personnel problems, hiring, promotion, performance and evaluation, payrolling, training and incentive systems. That was $24 billion in 1960. Now, it is 103 billion.

So right off the bat now you have $263 billion cumulative elements that are exactly the same in business.

Finally, in financing, which was $6 billion in 1960, and $100 billion in 1983. That is compatible accounting systems. We have over 300 incompatible accounting systems in the government. Borrowings, investing, cash management, auditing, controls and debt collection are absolutely, completely identical between business and government.

So you have $363 billion of the $800 billion roughly of government expenditures that are completely compatible as between business and Government. The other $437 billion is transfer programs including the administrative cost thereof. Here you have organization, quality controls, staffing, financial controls to eliminate fraud, performance standards and auditing.

So the only point we were trying to make here is that there is logic to ask business people who must survive doing these kind of things. If their bottom line does not add up, they go out of business. We do feel that people who have been in a survival mode, you gentlemen here, Senators, you are political survivors. We in business are financial survivors. We go broke. We are out of business.

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[1] See p. 34.

We think there is a lot of compatible elements between business and Government where the business people could be expected theoretically to be able to make suggestions.

Now, that covers the charts. I can go as slow or as fast as you gentlemen want me to or leave the matter in for the record. Just keep rolling it along? OK. And stop me or correct me or do anything.

$302 BILLION OF UNDUPLICATED SAVINGS

Because of the overlap between our organizationally focused task force and our cross-cutting functional task forces, we went across the Government in all of the different main functions—we had duplications of savings. Now, these savings and revenues opportunities have been unduplicated. So if anybody tells you that there is a lot of duplications in there, there were and we said it from day 1.

Under the Federal Advisory Committee Act, we had to come out with our reports as they were issued. We could not wait until the whole thing was done. So there were duplications. We said there were duplications from day 1. We have now unduplicated the whole thing and we are at $302 billion unduplicated.

So if anybody tells you were duplicated——

Senator **Armstrong**. That $302 billion relates to a 3-year period?

Mr. **Grace**. Yes, sir, 3-year saving. If anybody tells you it is duplicated, say that is behind you. It is unduplicated and it is $302 billion of 3 years or over $100 billion each year plus cash flow improvements of $20 billion each year.

Overall about 60 percent is congressional action and about 40 percent administrative. Based on reports being released next month and the rest of this month, we are coming out with some reports tomorrow at the public reading room of the Department of Commerce. We are coming out with other reports in December. We expect to exceed substantially the $302 billion of unduplicated savings. How much I do not know. I have a target figure. But I would just as soon not mention it. But it is going to be much bigger than $302 billion.

DEFENSE SAVINGS

We thought we would go through quickly a sampling of some typically important recommendations. For instance, of the $302 billion over 3 years, $94 billion of that amount relates to the Department of Defense, and 80 percent of that requires congressional activity.

In the area of defense, we have noted that weapons systems selection, DOD budgeting and the congressional appropriations process, the interrelation of these three elements are not sufficiently integrated to allow orderly and economic management of weapons acquisition.

For example, our Navy task force found that only 2 of the approximately 70 major weapons systems in production were being procured on an economic production schedule. Our task force reviewing operations in the Office of the Secretary of Defense found that over a 7-year period, the cost of 25 major weapons systems increased from their initial estimates of $104.8 billion to $339.2 billion or by 3.2 times, more than half of the increase resulted from program changes. Production stretchouts on the Army's Black Hawk helicopter added $2.5 billion or 50 percent to the program's cost.

To bring greater stability to the weapon's acquisition process, our four defense-related task forces and our procurement task force recommended the adoption of multiyear budgeting and multiyear procurement for major weapons systems and the cancellation of deferral of the less essential programs to allow maintenance of economic production rates, an inefficient and uneconomical response to budgetary pressures.

More than $3.4 billion could be saved over 3 years by more extensive use of dual sourcing. They knocked the dual sourcing out too early. In particular, our Navy and Air Force task force recommended up-front budgeting of the funds necessary to qualify and maintain two competitive sources over the entire production life of a weapons systems so we do not get in the hands of one supplier too soon.

Operational reforms in the military could save at least $13.2 billion over 3 years through improved management of inventories and by using common parts and standards wherever possible.

Our Office of the Secretary of Defense task force found that antiquated computer systems prevented the procurement of inventory items in economic order quantities. A $1.4 billion expenditure to upgrade ADP hardware and software would allow a one-time reduction in inventories of $4.3 billion and provide continual savings of more than $1 billion annually.

By the way, in the ADP area there are a number of instances where you put some bread on the water where it comes back many times in a very short period.

Further, we determined that procurement officials are not sufficiently selective in identifying items required to meet military standards and specifications. This means excessive costs resulting from the verification of standards and the specification of qualities unnecessary to the end product.

Our OSD task force recommended establishing cross-service standardization and the application of military specifications only when truly necessary, when and where truly necessary. The latter recommendation would be achieved in part by providing financial incentives to encourage contractors to challenge unimportant or irrelevant standards. Estimated savings of $7.2 billion over 3 years were projected following implementation of this recommendation.

PRIVATIZATION

Now, privatization is another task force. I am leaving defense now and moving on to privatization. There are many services currently performed by the Federal Government which could be turned over to the private sector—privatizing—including the power marketing administrations, military commissaries, and selected Coast Guard services.

Regarding the power marketing administrations, PMA's, we have noted that these agencies charge roughly two-thirds and less for power than comparable rates offered by private sector utilities.

This is because the PMA's are subsidized operations and benefit from access to cheap hydroelectric power developed at taxpayer expense.

While charging less than full market rates, the PMA's are not meeting their financial obligations. Between 1980 and 1982, the expenses including capital investment exceeded revenues by $1.7 billion.

PPSSCC recommends that the Federal Government begin an orderly process of disengagement from the commercial generation of electric power. In addition, a system of fees should be established to charge users for the access to valuable water resource projects. In addition, all future hydroelectric power development should be financed from non-Federal sources.

Savings and revenue enhancements from privatizing the PMA's could total $19.8 billion over 3 years primarily reflecting the estimated proceeds from the sale of the PMA's.

The operation of military commissaries in the continental United States is another function which could be privatized. Commissaries were originally established to serve the military in frontier posts situated miles from the nearest city. This is not the case today. There are 238 commissaries operating in the United States, and many are concentrated in large cities, including 6 in Washington, D.C., 5 in San Francisco, 5 in San Antonio, Tex., where products are available from alternative private sector stores. It costs $758 million to operate military commissaries in fiscal 1983.

We recommend that the commissary space at military facilities be rented to private operators, so that in addition to eliminating Federal expenditures to operate these commissaries the revenues would increase from the rentals. We recommend savings of $2.1 billion over 3 years and revenue increases of $383.2 million.

We are recommending also that selected services offered by the Coast Guard be privatized. About 80 percent of the Coast Guard's safety and rescue missions are non-life-threatening, and of course, only rich people have yachts.

Specifically, PPSSCC recommends that the Coast Guard utilize the private sector towing industry in non-life-threatening situations which account for at least 50 percent of the work load of the Coast Guard, and that the Coast Guard contract out its heavy-lift routine maintenance work for marine and inland buoy tending as well as its program for quick response to navigation aid failures.

These are three functions which could be privatized. As a rough count, at least 17 PPSSCC task forces have identified areas where privatization should be considered with potential 3-year savings and revenue enhancements of $28.4 billion.

HEALTH CARE

Turning toward domestic expenditures, looking at health care, $80 billion in 1983, $53 billion for medicare and $19 billion for medicaid with an additional $8 billion for hospital and medical care for veterans. So that is around, you might say, $90 billion altogether.

Now, several general problems were identified in relation to the health program. First, as you pointed out, Senator Chiles, you have this question of the retrospective reimbursement and the cost-plus basis, and they have no incentive. In fact, a disincentive in the hospitals to restrain costs.

Physicians have no incentive to provide services on a cost effective basis, and individuals largely insulated by insurance from health care costs have no incentive to limit their demand for services or to critically review the services provided.

The impact of no one, so-called "watching the store" on health care costs is readily apparent. From 1960 to 1980, spending by the Government on health care has increased from $3 billion to $71 billion which is an increase of 2,200 percent.

In addressing these problem areas, we have recommended a shift from retrospective payment to a fixed fee prospective payment system for hospitals and physicians in both the medicare and medicaid programs.

A review of 10 States using prospective payment rather than retrospective payment systems have shown a 55-percent average reduction in projected cost increases. That is a 55-percent reduction.

We have estimated 3 years savings of about $10 billion resulting from the shift from retrospective to prospective payments systems and other recommendations to allow market forces to mitigate cost increases. A billion in savings can be realized through administrative action with the remaining $9 billion implemented under congressional authority. A first step in this connection has been taken with recent legislation pointed out by Senator Chiles which provides for a phasein of a prospective reimbursement system for medicare hospital costs.

As a second major point, the Government's health care programs encourage new capacity and discourage elimination of existing excess capacity.

More than $4 billion can be saved over 3 years primarily through administrative initiatives to reduce excess hospital capacity. Congressional action to eliminate the tax exempt status of hospital bonds will both restrain new hospital construction and increase tax revenues with resulting 3 years savings of $662 million.

In the Veterans' Administration, the health facilities construction program is excessive in cost and in view of low utilization rates offers significant opportunity for cost saving, albeit controversial as you said, Senator Chiles.

The six VA nursing homes completed in 1980 and 1981 average four times the cost per bed of two private sector companies constructing nursing homes in the same period. In the Bronx in New York from where I come the VA hospital completed in 1980 cost $191,300 per bed or twice the $97,400 cost per bed of the Duke University Hospital completed at the same time.

There is constant examples of this nature. We are only citing the high spots.

Our recommendations include the discontinuation of VA nursing home construction and instead we suggest that underutilized hospital beds should be converted to nursing care. We all know there are too many hospital beds, and if they were converted to nursing care, a lot could be saved.

VA hospital construction should be phased out and increased contracting to the private sector for both nursing home and hospital beds should be substituted. Phaseout of new VA hospital construction would save $554 million over 3 years.

ACCOUNTING AND FINANCIAL ACTIVITIES

In reviewing the Government's management functions, we have noted there is no critical Government organization responsible for directing and coordinating Federal accounting and financial activities. You have all these incompatible accounting systems. There is inadequate agency and governmentwide financial accounting and reporting, inconsistent application of accounting procedures as between the agencies, unreliable financial data, unbelievably unreliable financial data. Corporations would be broke if they were working on the same basis of the financial data we find down here. Duplicate systems development, and no centralized reporting of results.

There are, for example, over 300, as I said, incompatible accounting systems in Government agencies. We found the cost of issuing a payroll check to be about $4 in two agencies where the data was available, and most of the time it is not available. You cannot get the data. That compares to a private sector cost of 75 cents to $1.25. Call it a $1. So it is four times the expense. With more than 8 million active and retired military and civilian employees, tens of millions of social security recipients, the excess costs of check issuance are enormous. There were 665 million checks issued in 1983. And if you have a $3 excess cost, you got $1.9 billion right there in just inefficiency in the cost of issuing checks.

The average of Government computers is almost 7 years. That is twice that of the private sector which is about 3½years. The Government's current 5-year replacement plan would increase this. It is unbelievable. The Government plan would increase this from 7 years to 10.1 years.

The alternate replacement schedule recommended by our Commission would replace all computers over 5 years old, reduce the average age to 4.4 years and result in net savings of $4 billion over 3 years.

The problems in financial control lead to problems in cash management. The Government spends and collects every year, at this rate this year, $1.7 trillion, almost $1 billion every working hour. The Government cannot determine its cash balance at any point in time. We would save $23.5 billion over 3 years by:

Accelerating Government tax collections by earlier settlement of tax court cases could save $4 billion over 3 years by the addition of 75 administrative law judges.

The IRS has a backlog of delinquent taxes of $23.2 billion. By allocating IRS staff resources on a cost-benefit basis the way business does, increasing clerical support to revenue officers and enhancing collection techniques, $3.9 billion can be saved over 3 years.

By adding 2,500 additional tax examiners in each of the next 3 years, additional revenues of $2.7 billion can be collected. Tax examinations produce a direct effect on tax compliance, and with a tax gap estimated at $133 billion this year, the opportunity for additional collections is significant.

By simply paying bills when due rather than on a first-in first-out basis, FIFO, $1.3 billion over 3 years can be saved.

Electronic funds transfer can save the Government $1.6 billion over 3 years. Account withdrawal on installment payments could save $821 million and using EFT, that is electronic funds transfer, to collect alcohol and cigarette excise taxes could save $294 million.

An estimated $250 billion was, that is a quarter of a trillion, was owed to the Federal Government at the end of fiscal year 1982. Over $38 billion of that was delinquent or in default, and almost half of the delinquencies were more than 6 months past due. Almost $2 billion in bad debts were written off in fiscal year 1982, and an additional $2.5 billion will be written off during the next 18 months.

We recommend uniform definition for terms such as debt, delinquent debt, allowance for doubtful account and writeoff. Government agencies are simply not speaking the same language, and until they do, corrective action is unlikely. That is part of this incompatible financial system situation.

There should be uniform procedures which will involve creating separate credit departments in each agency and the use of Internal Revenue Service tax refund moneys to offset debts owed to the Government. No corporation would ever pay anybody money if they owed them money in another account.

Use of private collection agencies and credit bureaus to supplement collection and credit granting efforts of the Government. I mean, a credit agency goes after people four to five times to the three or four times that a Government agency goes after them, and they go after them tough because they have the incentive to get the money.

We should charge interest and penalties on delinquent debt.

DEFICIT GREATER THAN REPORTED

There are many more recommendations in our task force reports. We have only included the high spots here, and there are very important savings in amendments to the military pensions and the civil service pension system, both of which are not accounted for in the Federal Government's annual accounting, and we are going to come up with a proper accounting system of what the Government deficit is if you look at the thing in real terms.

The SEC tells us how we have to report our results. We suggest the SEC turn their attention to the Federal Government and we are going to do it for them, and you are going to see that the deficit is much, much greater than it is reported.

For instance, right off the bat, we have $1.1 trillion in unreserved for future liabilities in these pension systems, and there would be somewhere around 80 percent added to the payroll costs of $61 billion in the civil service system situation if you added reserves over a 40-year amortization period.

The results of our efforts present a very real opportunity for a bipartisan initiative by the Congress and the administration to join forces in reducing the cost of Government. Difficult though it may be, the consequences of not capitalizing on the recommendations that we call a "window of opportunity" are likely to yield even less desirable alternatives for the American people, and I repeat that it is 9 to 12 times in 6 years, and 29 times to 51 times in 12 years.

On a more positive note, many of our recommendations are already in the process of being reviewed for the purpose of implementation. The White House has put together a comprehensive mechanism for the purpose of reviewing with the departments and agencies, the Office of Management and Budget and the Office of Policy Development in the White House each and every issue contained in the task force reports.

They have a page for each suggestion. We are going to come out with 2,500 suggestions at the end. They will have a page for each one, and the representatives from our Commission actively participate in these deliberations in the White House.

COMMISSION EFFORTS BEGIN TO PAY OFF

Our efforts are beginning to pay off as evidenced by the two recent articles in the Washington Post—we do read the newspaper in our Commission, too—and a new release by the Department of Education showing examples of our Commission recommendations.

One is a $4.7 billion savings for the fiscal year 1985 budget for the implementation of our Commission's cash management improvement recommendations across Government. That is $4.7 billion.

A reduction of 1,200 Federal employees from the role of the Department of Health and Human Services as identified and recommended by our Commission with an $172 million savings over 3 years.

An initiative undertaken by Secretary Bell at the Department of Education regarding delinquent student loans with an initial focus on 41,000 current or retired Federal employees owing more than $65 million in delinquent student loans.

You just got to go after these things one by one.

While the early signs are most encouraging, it must continue as much, much more needs to be done.

I have used up my time and more so I am sure. I hope the samples I have chosen give the committee an idea of the variety of recommendations and an identification of some of the larger potential and possible savings.

It should be emphasized that our recommendations have different degrees of documentation and the savings, of course, are estimates. They should be understood to be of planning quality rather than of a budget quality. We did not have the time nor the resources. We spent $73 million of private funds to go through to make it real budget quality.

Many of our recommendations will understandably require further review and analysis prior to implementation. However, what is important is that we have identified thousands of opportunities for cost savings, totaling over $100 billion a year without cost to the Government.

The entire Commission effort was funded by private sector funds, and we will have spent in excess of $75 million. I thank you, Mr. Chairman, for the opportunity to attend the hearing.

Senator ARMSTRONG. Thank you, Mr. Grace.

[The prepared statement of Mr. Grace follows:]

TESTIMONY OF MR. J. PETER GRACE
BEFORE THE SENATE BUDGET COMMITTEE
NOVEMBER 7, 1983
DIRKSEN SENATE OFFICE BUILDING - ROOM 608 (SIXTH FLOOR)

THANK YOU, MR. CHAIRMAN. I AM PLEASED TO BE HERE TODAY, AND TO HAVE THE OPPORTUNITY TO SHARE WITH YOUR COMMITTEE SOME OF THE FINDINGS AND RECOMMENDATIONS OF THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL (PPSSCC).

MY NAME IS PETER GRACE, AND I AM CHAIRMAN OF THE PPSSCC AND CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF W. R. GRACE & CO. WITH ME ARE FELIX E. LARKIN, A MEMBER OF THE EXECUTIVE COMMITTEE AND AN ASSOCIATE OF MINE AT W. R. GRACE & CO.; J. P. BOLDUC, CHIEF OPERATING OFFICER OF THE SURVEY'S MANAGEMENT OFFICE; AND MR. J. GISH, WHO IS ON THE GRACE STAFF.

WHILE THESE ARE DIFFICULT TIMES, WHICH WILL INEVITABLY REQUIRE SOME VERY TOUGH DECISIONS IF WE ARE TO RETURN TO A STATE OF FISCAL SANITY IN THIS COUNTRY, I AM ENCOURAGED BY THE MEDIA COVERAGE OF THE PAST FEW DAYS WHICH INDICATES A LEVEL OF CONGRESSIONAL COMMITMENT TO DOING SOMETHING ABOUT UNCONTROLLED GOVERNMENT SPENDING AND THE ATTENDANT RUN-AWAY DEFICITS. MY REMARKS TODAY ARE FOCUSED ON FOUR MAJOR AREAS:

A. I WILL BRIEFLY SUMMARIZE WHAT IS LIKELY TO RESULT IF THE GOVERNMENT'S CURRENT FINANCIAL SITUATION IS NOT CORRECTED.

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B. I WILL PROVIDE AN OVERVIEW OF WHAT THE PRESIDENT'S PRIVATE SECTOR SURVEY HAS FOUND IN SAVINGS AND REVENUE ENHANCEMENT OPPORTUNITIES.

C. I WILL DISCUSS SPECIFIC EXAMPLES OF SAVINGS AND REVENUE OPPORTUNITIES.

D. AND LASTLY, I WILL SHARE WITH YOU WHY I'M CONVINCED THAT THE TIME FOR ACTION IS NOW AND WHY PPSSCC RECOMMENDATIONS CAN SERVE AS THE VEHICLE TO EFFECT MEANINGFUL IMPROVEMENT IN THE MANAGEMENT OF THE GOVERNMENT'S BUSINESS WHILE AT THE SAME TIME REALIZING SUBSTANTIAL REDUCTIONS IN COST AND INCREASES IN REVENUE.

I WOULD LIKE TO START WITH A CHART THAT SHOWS FEDERAL GOVERNMENT REVENUES, OUTLAYS AND DEFICITS IN THE YEARS 1965, 1975 AND 1983 AND EXTRAPOLATIONS TO THE YEARS 1990 AND 2000 AT THREE DIFFERENT GROWTH RATES.

(CHART FOLLOWS)

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FEDERAL GOVERNMENT REVENUES, OUTLAYS AND DEFICITS

($ Billions)

	Revenues	Outlays	Deficits	Outlays as a Multiple of Revenues
1965	$117	$118	$ (1)	1.01X
1975	279	324	(45)	1.16
1983E	601	796	(195)	1.33
Average Annual Percent Increase				
1965-1983E	9.5%	11.2%	30.6%	
1975-1983E	10.1	11.9	20.1	
	Extrapolated At 1965-1983E Rate			
1990	$1,134	$1,673	(539)	1.48X
2000	2,810	4,838	(2,028)	1.72
	Extrapolated At 1975-1983E Rate			
1990	1,178	1,749	(571)	1.48X
2000	3,083	5,382	(2,299)	1.75
	Extrapolated At Equal 10.0% Rates			
1990	1,170	1,551	(381)	1.33X
2000	3,036	4,023	(987)	1.33

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AS CAN BE SEEN, BETWEEN 1965 AND 1983, REVENUES GREW AT AN AVERAGE ANNUAL RATE OF 9.5% BUT OUTLAYS GREW AT AN AVERAGE ANNUAL RATE OF 11.2%, AN ADVERSE DIFFERENTIAL OF 1.7% POINTS. HOWEVER, THIS ADVERSE DIFFERENTIAL IN THE GROWTH RATES RESULTED IN THE DEFICIT INCREASING FROM $1 BILLION IN 1965 TO $195 BILLION IN 1983. PUT ANOTHER WAY, OUTLAYS AS A MULTIPLE OF REVENUES WENT FROM 1.01 TIMES IN 1965 TO 1.33 TIMES IN 1983 DUE TO THIS 1.7% POINT ADVERSE DIFFERENTIAL IN THE GROWTH RATE OF REVENUES AND OUTLAYS. BETWEEN 1975 AND 1983, THE ADVERSE DIFFERENTIAL IN THE GROWTH RATES WAS 1.8% POINTS.

EXTRAPOLATING TO THE YEAR 1990, THE DEFICIT WILL INCREASE TO $539 BILLION AT THE 1965-1983 GROWTH RATES AND TO $571 BILLION AT THE 1975-1983 GROWTH RATES, WITH OUTLAYS UP TO 1.48 TIMES REVENUES. IF THE ADVERSE DIFFERENTIAL IN GROWTH RATES WERE ELIMINATED AND REVENUES AND OUTLAYS BOTH GREW AT AVERAGE ANNUAL RATES OF 10.0%, OUTLAYS WOULD STILL BE 1.33 TIMES REVENUES BUT THE DEFICIT WILL HAVE GROWN TO $381 BILLION.

SIMILARLY, EXTRAPOLATING TO THE YEAR 2000, THE DEFICIT WILL INCREASE TO $2.0 TRILLION AT THE 1965-1983 GROWTH RATES AND TO $2.3 TRILLION AT THE 1975-1983 GROWTH RATES, WITH OUTLAYS UP TO 1.75 TIMES REVENUES. WITH EQUAL GROWTH RATES, THE DEFICIT WOULD REACH $1.0 TRILLION, OR 5.1 TIMES THE 1983 DEFICIT.

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THUS, THE TRENDS IN THE GROWTH RATES OF REVENUES AND OUTLAYS WILL BRING THE DEFICIT TO OVER $2.0 TRILLION IN THE YEAR 2000 AND, BECAUSE THERE IS ALREADY A LARGE MISMATCH, EVEN WITH EQUAL GROWTH RATES, THE DEFICIT WILL REACH $1.0 TRILLION.

THE PRECEDING CHART IS THE RESULT OF SIMPLY EXTRAPOLATING TOTAL REVENUES AND TOTAL OUTLAYS. THE NEXT CHART SHOWS A SUMMARY OF THE INITIAL, "FIRST CUT" AT THIS WHICH HAS BEEN MADE BY DATA RESOURCES INC., (DRI), A WIDELY RECOGNIZED ECONOMIC FORECASTING FIRM, USING A SOPHISTICATED ECONOMETRIC COMPUTER MODEL OF THE U.S. ECONOMY AND ALL THE REVENUE AND OUTLAY COMPONENTS OF THE FEDERAL BUDGET.

(CHART FOLLOWS)

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DRI "Status Quo" Projections

($ Billions)

	Revenues	Outlays	Deficits	Outlays As A Multiple of Revenues
1965	$117	$118	$ (1)	1.01X
1975	279	324	(45)	1.16
1983E	601	796	(195)	1.33
1990	1,247	1,633	(386)	1.31
2000	3,447	5,485	(2,038)	1.59
Average Annual Percent Increase				
1965-1983E	9.5%	11.2%	30.6%	
1975-1983E	10.1	11.9	20.1	
1983E-1990	11.0%	10.8%	10.2%	
1983E-2000	10.8	12.0	14.8	

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AS CAN BE SEEN WITH THIS MORE DETAILED ECONOMETRIC ANALYSIS, THE DEFICIT INCREASES TO $386 BILLION IN 1990 AND TO $2.0 TRILLION IN THE YEAR 2000.

CLEARLY, THE FISCAL PROBLEM FACING THE U.S. WILL GET MUCH WORSE UNLESS SOMETHING IS DONE TO REVERSE PAST TRENDS.

IT SHOULD BE RECOGNIZED THAT RAISING TAXES IS NOT A VIABLE SOLUTION, FOR TWO REASONS: THE EXTENT TO WHICH MIDDLE INCOME TAXPAYERS ARE ALREADY BEING TAXED, AND THE RELATIVELY SMALL AMOUNT OF TOTAL INCOME WHICH EXISTS IN THE HIGHER TAX BRACKETS.

THE NEXT CHART SHOWS INCOME AND SOCIAL SECURITY TAXES, AVERAGE TAX RATES AND, IN CONSTANT DOLLARS, DISCRETIONARY AFTER TAX INCOME FOR VARIOUS LEVELS OF GROSS INCOME IN THE YEARS 1948, 1981 AND 1983.

(CHART FOLLOWS)

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WHAT HAS HAPPENED TO AMERICAN FAMILIES

(Summary Table)

		(1)	(2)	(3)	(4)
		1983 Gross Income			
		$20,000	$30,000	$40,000	$50,000
(1)	% Of Total Cumulative Income Captured At Each Bracket ⟶	63.0%	81.0%	86.9%	90.9%
		----- Total Income And Social Security Taxes Paid -----			
(2)	1948	$ 248	$ 556	$ 892	$ 1,251
(3)	1981	2,910	5,108	7,317	9,755
(4)	1983	2,982	5,183	7,516	9,961
		------------- Average Tax Rate -------------			
(5)	1948	5.1%	7.7%	9.3%	10.4%
(6)	1981	16.0	18.7	20.1	21.4
(7)	1983	14.9	17.3	18.8	19.9
		------ Discretionary After Tax Income ------ (Constant 1983 $)			
(8)	1948	$7,266	$13,268	$18,513	$28,681
(9)	1981	5,237	9,479	13,329	20,880
(10)	1983	5,309	9,654	13,582	21,301
	% Inc./(Dec.)				
(11)	1948-1981	(27.9)%	(28.6)%	(28.0)%	(27.2)%
(12)	1981-1983	1.4	1.8	1.9	2.0

Each family enjoyed an increase in real discretionary income under Reagan following 33 years of decline.

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FOR THE AMERICAN FAMILY WITH $20,000 OF GROSS INCOME IN 1983, -- INCOME AND SOCIAL SECURITY TAXES AS A PERCENT OF GROSS INCOME INCREASED FROM 5.1% IN 1948 TO 16.0% IN 1981, OR MORE THAN TRIPLE, BEFORE IT WAS REDUCED SLIGHTLY TO 14.9% IN 1983 UNDER PRESIDENT REAGAN. THIS FAMILY'S DISCRETIONARY AFTER TAX INCOME IN CONSTANT DOLLARS DECREASED BY (27.9)% BETWEEN 1948 AND 1981, BUT INCREASED BY 1.4% BETWEEN 1981 AND 1983.

OF PARTICULAR NOTE, AT $20,000 OF GROSS INCOME -- INCLUDING THE FIRST $20,000 OF THE GROSS INCOME OF TAXPAYERS IN HIGHER TAX BRACKETS -- 63.0% OF THE TOTAL CUMULATIVE INCOME IS CAPTURED.

THE EROSION OF DISCRETIONARY AFTER TAX INCOME THROUGH 1981 AND THE SLIGHT IMPROVEMENT SINCE THEN IS SIMILAR FOR ALL THE INCOME LEVELS SHOWN, UP TO $50,000 AT WHICH POINT 90.9% OF TOTAL CUMULATIVE INCOME IS CAPTURED.

THE NEXT CHART SHOWS THE PERCENTAGE OF TOTAL TAXABLE INCOME AND TAXES PAID BY BRACKET AND THE CUMULATIVE PERCENTAGES AND THE DOLLAR AMOUNTS LEFT ABOVE EACH BRACKET.

(CHART FOLLOWS)

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TAXABLE INCOME AND TAXES GENERATED FROM ALL TAXPAYERS BY BRACKET

(1983)

		(1)	(2)	(3)	(4)	(5)	(6)
		In Each Bracket		Cumulative		Dollar Amount Left After Each Bracket	
	Income Bracket ($000)	% Of Taxable Income	% Of Taxes Paid	% Of Taxable Income	% Of Taxes Paid	Taxable Income ($ Billions)	Taxes Paid
(1)	$ 0–$ 15	70.0%	40.0%	70.0%	40.0%	$493	$ 176
(2)	15– 20	10.0	10.0	80.0	50.0	328	147
(3)	20– 25	5.0	12.0	85.0	62.0	246	112
(4)	25– 30	2.5	12.0	87.5	74.0	205	76
(5)	30– 35	2.5	10.0	90.0	84.0	164	47
(6)	35– 40	2.0	6.0	92.0	90.0	131	29
(7)	40– 50	2.0	4.0	94.0	94.0	98	18
(8)	50– 75	4.0	4.0	98.0	98.0	33	6
(9)	75– 100	0.5	0.5	98.5	98.5	25	4
(10)	100– 150	0.5	0.5	99.0	99.0	16	3

Even if all taxable income in brackets of $75,000 and above were taken by the Federal Government, It would supply only 4.1% of the $805 billion Federal expenditure level budgeted for 1983.

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AS CAN BE SEEN, 90% OF TAXABLE INCOME IS CAPTURED AT INCOME LEVELS UNDER $35,000 AND 90% OF TAXES PAID ARE UNDER THE $40,000 INCOME LEVEL.

OF PARTICULAR NOTE, THERE IS ONLY $33 BILLION OF TAXABLE INCOME ABOVE THE $75,000 INCOME LEVEL WHICH, IF TAXED AT 100%, WOULD SUPPLY ONLY 4.1% OF FEDERAL GOVERNMENT EXPENDITURES.

THUS, INCREASING TAXES ON EITHER MIDDLE INCOME TAXPAYERS OR THE SO-CALLED "RICH" DOES NOT OFFER A VIABLE SOLUTION.

THE NEXT CHART SHOWS THE CUMULATIVE IMPACT OF $100 BILLION IN RECOMMENDED PPSSCC SAVINGS.

(CHART FOLLOWS)

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CUMULATIVE IMPACT OF $100 BILLION IN PPSSCC SAVINGS

($ Billions)

		(1)	(2)	(3)	(4)
		At 5% inflation 10% interest		At 10% inflation 15% interest	
	Year	Waste	Cumulative Savings	Waste	Cumulative Savings
(1)	1	$100	$ 105	$100	$ 108
(2)	2	105	227	110	244
(3)	3	110	367	121	414
(4)	4	116	528	133	625
(5)	5	122	712	146	884
(6)	6	128	921	161	1,201
(7)	7	134	1,159	177	1,587
(8)	8	141	1,429	195	2,055
(9)	9	148	1,735	214	2,619
(10)	10	155	2,080	236	3,298
(11)	11	163	2,470	259	4,113
(12)	12	171	2,910	285	5,087

$0.9-$1.2 trillion savings over the next 6 years by cutting $100 billion in waste now

$2.9-$5.1 trillion savings over the next 12 years by cutting $100 billion in waste now

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THIS CHART SHOWS THE CUMULATIVE IMPACT OF SAVING $100 BILLION PER YEAR -- WHICH INCREASES WITH INFLATION AND COMPOUND INTEREST. IN SIX YEARS, THE CUMULATIVE SAVINGS REACH $921 BILLION WITH 5% INFLATION AND 10% INTEREST AND $1.2 TRILLION WITH 10% INFLATION AND 15% INTEREST.

GOING OUT 12 YEARS -- OR THE AMOUNT OF TIME WHICH HAS ELAPSED SINCE 1971 -- THE CUMULATIVE SAVINGS REACH $2.9 TRILLION AND $5.1 TRILLION UNDER THESE TWO SCENARIOS. THIS IS BY SAVING $100 BILLION PER YEAR. ALTERNATIVELY, IF THE SAVINGS ARE NOT MADE, THE CUMULATIVE EFFECT IS ADDITIONAL SPENDING IN THESE AMOUNTS.

BEFORE PROCEEDING FURTHER, IT IS OF INTEREST TO NOTE THE DEGREE OF SIMILARITY WHICH EXISTS BETWEEN THE MANAGEMENT FUNCTIONS THAT COMPRISE THE FEDERAL GOVERNMENT AND THOSE IN THE PRIVATE SECTOR -- THE RATIONALE FOR ASKING A GROUP OF TOP CORPORATE EXECUTIVES TO COME TO WASHINGTON TO FIND WAYS TO MAKE GOVERNMENT MORE EFFICIENT.

THE NEXT CHART SHOWS FOR 1960 AND 1983 A ROUGH CUT AT BREAKING OUT THREE MAIN CATEGORIES OF FEDERAL GOVERNMENT SPENDING WHICH REQUIRE MANAGEMENT CAPABILITIES ESSENTIALLY IDENTICAL IN NATURE TO THOSE IN THE PRIVATE SECTOR -- AND WHICH BUSINESS MANAGEMENT MUST BE SUCCESSFUL AT IN ORDER TO SURVIVE.

(CHART FOLLOWS)

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The Federal Government and Business Management

	Federal Expenditures					
	$ Billions		% Increase	% of Total		Functions Common to Government and Business
	1960	1983	1960-1983	1960	1983	
Procurement	$20	$160	700%	22%	20%	Assurance of state-of-the-art equipment, competitive bidding, dual sourcing, inventory control and warehousing/distribution
Personnel	24	103	329	26	13	Hiring, promotion, performance and evaluation, payrolling, training and incentive systems.
Financing	6	100	1,567	6	12	Compatible accounting systems, borrowings, investing, cash management, auditing, controls, and debt collection.
Sub-Total	$50	$363	626%	54%	45%	
Transfer Programs	42	437	940	46	55	Organization, quality control, staffing, financial controls, performance standards and auditing.
TOTAL	$92	$800	770%	100%	100%	

AS CAN BE SEEN, THE CATEGORIES OF PROCUREMENT, PERSONNEL AND FINANCING -- ALL BASICALLY IDENTICAL IN NATURE IN GOVERNMENT AND BUSINESS -- TOTAL $363 BILLION OR 45% OF TOTAL EXPENDITURES IN 1983. THESE HAVE INCREASED FROM $50 BILLION IN 1960 WHEN THEY WERE 54% OF TOTAL EXPENDITURES.

THE BALANCE OF FEDERAL SPENDING IS IN TRANSFER PROGRAMS -- PROGRAMS WHICH LARGELY TRANSFER WEALTH FROM THE PRODUCTIVE TO THE LESS PRODUCTIVE MEMBERS OF SOCIETY -- AND THESE HAVE INCREASED FROM $42 BILLION OR 46% OF THE TOTAL IN 1960 TO $437 BILLION OR 55% OF THE TOTAL IN 1983. OF COURSE, IN THE PRIVATE SECTOR, THERE ARE NO FUNCTIONS WHICH ARE THE SAME IN NATURE AS TRANSFER PROGRAMS. HOWEVER, STANDARD BUSINESS PRACTICES ARE NECESSARY IN ORDER TO ENSURE THAT THIS PROCESS IS DONE AS EFFICIENTLY AS POSSIBLE. THUS, EFFECTIVE ORGANIZATION PLANNING AND DESIGN, STAFFING, FINANCIAL AND OPERATING CONTROLS, PERFORMANCE CRITERIA AND AUDITING ARE REQUISITES COMMON TO SUCCESS IN BUSINESS AND IN THE EFFICIENT EXECUTION OF TRANSFER PROGRAMS.

BECAUSE OF THE OVERLAP BETWEEN OUR ORGANIZATIONALLY FOCUSED TASK FORCES AND OUR CROSS CUTTING FUNCTIONAL TASK FORCES, DUPLICATING OF REPORTED SAVINGS OCCURRED AS WE HAD EXPECTED. THESE SAVINGS AND REVENUE OPPORTUNITIES HAVE NOW BEEN UNDUPLICATED AND TOTAL $302 BILLION OVER THREE YEARS OR OVER $100 BILLION EACH YEAR PLUS CASH FLOW IMPROVEMENTS OF $20 BILLION EACH

YEAR. OVERALL, ABOUT 60% OF THESE OPPORTUNITIES CAN BE REALIZED THROUGH CONGRESSIONAL ACTION AND 40% BY ADMINISTRATIVE DETERMINATION. WE EXPECT, BASED ON THE REPORTS BEING RELEASED THIS MONTH AND NEXT, TO EXCEED SUBSTANTIALLY THE TOTAL SAVINGS REPORTED SO FAR.

HAVING SAID ALL THAT, I WILL NOW IDENTIFY A SAMPLING OF SOME TYPICALLY IMPORTANT RECOMMENDATIONS CONTAINED IN OUR TASK FORCE REPORTS. MORE SPECIFICALLY, OF THE TOTAL ESTIMATED $300 BILLION OVER THREE YEARS, $94 BILLION OF THAT AMOUNT RELATES TO THE DEPARTMENT OF DEFENSE, 80% OF WHICH REQUIRES CONGRESSIONAL ACTION.

IN THE AREA OF DEFENSE, WE HAVE NOTED THAT WEAPONS SYSTEMS SELECTION, DOD BUDGETING, AND THE CONGRESSIONAL APPROPRIATIONS PROCESS ARE NOT SUFFICIENTLY INTEGRATED TO ALLOW ORDERLY AND ECONOMIC MANAGEMENT OF WEAPONS ACQUISITION. FOR EXAMPLE, OUR NAVY TASK FORCE FOUND THAT ONLY TWO OF THE APPROXIMATELY SEVENTY MAJOR WEAPONS SYSTEMS IN PRODUCTION WERE BEING PROCURED ON AN ECONOMIC PRODUCTION SCHEDULE. OUR TASK FORCE REVIEWING OPERATIONS IN THE OFFICE OF THE SECRETARY OF DEFENSE (OSD) FOUND THAT OVER A SEVEN YEAR PERIOD THE COST OF 25 MAJOR WEAPONS SYSTEMS INCREASED FROM THEIR INITIAL ESTIMATES OF $104.8 BILLION TO $339.2 BILLION OR BY 3.2 TIMES. MORE THAN HALF OF THE INCREASE RESULTED FROM PROGRAM CHANGES. PRODUCTION STRETCH-OUTS ON THE ARMY'S BLACK HAWK HELICOPTER ADDED $2.5 BILLION OR 50% TO THE PROGRAM'S COST.

TO BRING GREATER STABILITY TO THE WEAPONS ACQUISITION PROCESS, OUR FOUR DEFENSE-RELATED TASK FORCES AND OUR PROCUREMENT TASK FORCE RECOMMENDED:

- THE ADOPTION OF MULTI-YEAR BUDGETING AND MULTI-YEAR PROCUREMENT FOR MAJOR WEAPONS SYSTEMS, AND
- THE CANCELLATION OR DEFERRAL OF LESS ESSENTIAL PROGRAMS TO ALLOW MAINTENANCE OF ECONOMIC PRODUCTION RATES -- AN INEFFICIENT AND UNECONOMICAL RESPONSE TO BUDGETARY PRESSURES.

MORE THAN $3.4 BILLION COULD BE SAVED OVER THREE YEARS BY MORE EXTENSIVE USE OF DUAL SOURCING. IN PARTICULAR, OUR NAVY AND AIR FORCE TASK FORCES RECOMMENDED UP-FRONT BUDGETING OF THE FUNDS NECESSARY TO QUALIFY AND MAINTAIN TWO COMPETITIVE SOURCES OVER THE ENTIRE PRODUCTION LIFE OF A WEAPONS SYSTEM.

OPERATIONAL REFORMS IN THE MILITARY COULD SAVE AT LEAST $13.2 BILLION OVER THREE YEARS THROUGH IMPROVED MANAGEMENT OF INVENTORIES AND BY USING COMMON PARTS AND STANDARDS WHEREVER POSSIBLE.

OUR OSD TASK FORCE FOUND THAT ANTIQUATED COMPUTER SYSTEMS PREVENTED THE PROCUREMENT OF INVENTORY ITEMS IN ECONOMIC ORDER QUANTITIES. A $1.4 BILLION EXPENDITURE TO UPGRADE ADP HARDWARE AND SOFTWARE WOULD ALLOW A ONE-TIME REDUCTION IN

INVENTORIES OF $4.3 BILLION AND PROVIDE CONTINUING SAVINGS OF MORE THAN $1 BILLION ANNUALLY.

FURTHER, WE DETERMINED THAT PROCUREMENT OFFICIALS ARE NOT SUFFICIENTLY SELECTIVE IN IDENTIFYING ITEMS REQUIRED TO MEET MILITARY STANDARDS AND SPECIFICATIONS. THIS MEANS EXCESSIVE COSTS RESULTING FROM THE VERIFICATION OF STANDARDS AND THE SPECIFICATION OF QUALITIES UNNECESSARY TO THE END PRODUCT.

OUR OSD TASK FORCE RECOMMENDED ESTABLISHING CROSS-SERVICE STANDARDIZATION AND APPLICATION OF MILITARY SPECIFICATIONS ONLY WHERE TRULY NECESSARY. THE LATTER RECOMMENDATION WOULD BE ACHIEVED, IN PART, BY PROVIDING FINANCIAL INCENTIVES TO ENCOURAGE CONTRACTORS TO CHALLENGE UNIMPORTANT OR IRRELEVANT STANDARDS. ESTIMATED SAVINGS OF $7.2 BILLION OVER THREE YEARS WERE PROJECTED FOLLOWING IMPLEMENTATION OF THIS RECOMMENDATION.

NOW, LET ME TURN TO ANOTHER INTERESTING TASK FORCE STUDY, THE ONE WE CALL PRIVATIZATON.

THERE ARE MANY SERVICES CURRENTLY PERFORMED BY THE FEDERAL GOVERNMENT WHICH COULD BE TURNED OVER TO THE PRIVATE SECTOR -- PRIVATIZING -- INCLUDING THE POWER MARKETING ADMINISTRATIONS, MILITARY COMMISSARIES, AND SELECTED COAST GUARD SERVICES.

REGARDING THE POWER MARKETING ADMINISTRATIONS (PMAs), WE HAVE NOTED THAT THESE AGENCIES CHARGE ROUGHLY TWO-THIRDS LESS FOR POWER THAN COMPARABLE RATES OFFERED BY PRIVATE SECTOR UTILITIES. THIS IS BECAUSE THE PMAs ARE SUBSIDIZED OPERATIONS AND BENEFIT FROM ACCESS TO CHEAP HYDROELECTRIC POWER DEVELOPED AT TAXPAYER EXPENSE.

WHILE CHARGING LESS THAN FULL MARKET RATES, THE PMSs ARE NOT MEETING THEIR FINANCIAL OBLIGATIONS. BETWEEN 1980 AND 1982, EXPENSES, INCLUDING CAPITAL INVESTMENT, EXCEEDED REVENUES BY $1.7 BILLION.

PPSSCC RECOMMENDS THAT THE FEDERAL GOVERNMENT BEGIN AN ORDERLY PROCESS OF DISENGAGEMENT FROM THE COMMERCIAL GENERATION OF ELECTRIC POWER. IN ADDITION, A SYSTEM OF FEES SHOULD BE ESTABLISHED TO CHARGE USERS FOR THE ACCESS TO VALUABLE WATER RESOURCE PROJECTS. IN ADDITION, ALL FUTURE HYDROELECTRIC POWER DEVELOPMENT SHOULD BE FINANCED FROM NON-FEDERAL SOURCES.

SAVINGS AND REVENUE ENHANCEMENTS FROM PRIVATIZING THE PMAs COULD TOTAL $19.8 BILLION OVER THREE YEARS PRIMARILY REFLECTING THE ESTIMATED PROCEEDS FROM SALE OF THE PMAs.

THE OPERATION OF MILITARY COMMISSARIES IN THE CONTINENTAL U.S. IS ANOTHER FUNCTION WHICH COULD BE PRIVATIZED. COMMISSARIES WERE ORIGINALLY ESTABLISHED TO SERVE SOLDIERS IN FRONTIER POSTS SITUATED MILES FROM THE NEAREST CITY. THIS IS NOT

THE CASE TODAY. THERE ARE 238 COMMISSARIES OPERATING IN THE U.S., AND MANY ARE CONCENTRATED IN LARGE CITIES, INCLUDING SIX IN WASHINGTON, D.C., FIVE IN SAN FRANCISCO, AND FIVE IN SAN ANTONIO, WHERE PRODUCTS ARE AVAILABLE FROM ALTERNATIVE PRIVATE SECTOR STORES. IT COST $758 MILLION TO OPERATE MILITARY COMMISSARIES IN FY 1983.

PPSSCC RECOMMENDS THAT THE COMMISSARY SPACE AT MILITARY FACILITIES BE RENTED TO PRIVATE OPERATORS, SO THAT IN ADDITION TO ELIMINATING FEDERAL EXPENDITURES TO OPERATE THESE COMMISSARIES, FEDERAL REVENUES WOULD ALSO INCREASE. WE ESTIMATE THREE YEAR SAVINGS OF $2.1 BILLION AND REVENUE INCREASES OF $383.2 MILLION.

WE ARE ALSO RECOMMENDING THAT SELECTED SERVICES OFFERED BY THE COAST GUARD BE PRIVATIZED. ABOUT 80% OF THE COAST GUARD'S SAFETY AND RESCUE MISSIONS ARE NON-LIFE-THREATENING. SPECIFICALLY, PPSSCC IS RECOMMENDING THAT THE COAST GUARD UTILIZE THE PRIVATE SECTOR TOWING INDUSTRY IN NON-LIFE-THREATENING SITUATIONS, WHICH ACCOUNT FOR AT LEAST 50 PERCENT OF THE WORK LOAD, AND THAT THE COAST GUARD CONTRACT OUT ITS HEAVY-LIFT ROUTINE MAINTENANCE WORK FOR MARINE AND INLAND BUOY TENDING AS WELL AS ITS PROGRAM FOR QUICK RESPONSE TO NAVIGATIONAL AID FAILURES.

THE PRECEDING ARE JUST THREE FUNCTIONS WHICH COULD BE PRIVATIZED. AS A ROUGH COUNT, AT LEAST SEVENTEEN PPSSCC TASK FORCES HAVE IDENTIFIED AREAS WHERE PRIVATIZATION SHOULD BE

CONSIDERED, WITH POTENTIAL THREE YEAR SAVINGS AND REVENUE ENHANCEMENTS OF $28.4 BILLION.

TURNING TOWARD DOMESTIC SPENDING, GOVERNMENT OUTLAYS FOR HEALTH CARE WERE ESTIMATED AT ABOUT $80 BILLION IN 1983 -- $53 BILLION FOR MEDICARE AND $19 BILLION FOR MEDICAID -- WITH AN ADDITIONAL $8 BILLION SPENT TO PROVIDE HOSPITAL AND MEDICAL CARE FOR VETERANS.

SEVERAL GENERAL PROBLEMS WERE IDENTIFIED IN RELATION TO THE GOVERNMENT'S HEALTH PROGRAMS.

FIRST, NORMAL MARKET FORCES HAVE BEEN BY-PASSED BY THE GOVERNMENT'S RETROSPECTIVE REIMBURSEMENT PROCEDURES SINCE

- HOSPITALS, REIMBURSED ON A COST-PLUS BASIS, HAVE NO INCENTIVE, IN FACT A DISINCENTIVE, TO RESTRAIN COSTS;
- PHYSICIANS HAVE NO INCENTIVE TO PROVIDE SERVICES ON A COST EFFECTIVE BASIS; AND
- INDIVIDUALS, LARGELY INSULATED BY INSURANCE FROM HEALTH CARE COSTS, HAVE NO INCENTIVE TO LIMIT THEIR DEMAND FOR SERVICES OR TO CRITICALLY REVIEW THE SERVICES PROVIDED.

THE IMPACT OF NO ONE "WATCHING THE STORE" ON HEALTH CARE COST IS READILY APPARENT -- FROM 1960 TO 1980 GOVERNMENT SPENDING ON HEALTH CARE HAS INCREASED FROM $3 BILLION TO $71 BILLION OR BY MORE THAN 2000%

IN ADDRESSING THESE PROBLEM AREAS, WE HAVE RECOMMENDED A SHIFT FROM RETROSPECTIVE PAYMENT TO A FIXED-FEE, PROSPECTIVE PAYMENT SYSTEM FOR HOSPITALS AND PHYSICIANS IN BOTH THE MEDICARE AND MEDICAID PROGRAMS.

OF INTEREST, A REVIEW OF 10 STATES USING PROSPECTIVE PAYMENT SYSTEMS SHOWED A 55% AVERAGE REDUCTION IN PROJECTED COST INCREASES.

OUR TASK FORCES ESTIMATED THREE YEAR SAVINGS OF ABOUT $10 BILLION RESULTING FROM THE SHIFT FROM RETROSPECTIVE TO PROSPECTIVE PAYMENT SYSTEMS AND OTHER RECOMMENDATIONS TO ALLOW MARKET FORCES TO MITIGATE COST INCREASES. APPROXIMATELY $1 BILLION IN SAVINGS CAN BE REALIZED THROUGH ADMINISTRATIVE ACTION WITH THE REMAINING $9 BILLION IMPLEMENTABLE UNDER CONGRESSIONAL AUTHORITY. A FIRST STEP IN THIS CONNECTION HAS BEEN TAKEN WITH RECENT LEGISLATION WHICH PROVIDES FOR A PHASE-IN OF A PROSPECTIVE REIMBURSEMENT SYSTEM FOR MEDICARE HOSPITAL COSTS.

AS A SECOND MAJOR POINT, THE GOVERNMENT'S HEALTH CARE PROGRAMS ENCOURAGE NEW CAPACITY AND DISCOURAGE THE ELIMINATION OF EXISTING EXCESS CAPACITY.

MORE THAN $4 BILLION CAN BE SAVED OVER THREE YEARS PRIMARILY THROUGH ADMINISTRATIVE INITIATIVES TO REDUCE EXCESS HOSPITAL CAPACITY. SIMILARLY, CONGRESSIONAL ACTION TO ELIMINATE THE TAX EXEMPT STATUS OF HOSPITAL BONDS WILL BOTH RESTRAIN NEW

HOSPITAL CONSTRUCTION AND INCREASE TAX REVENUES WITH RESULTING THREE YEAR SAVINGS OF $662 MILLION.

THE VETERANS ADMINISTRATION'S HEALTH FACILITIES CONSTRUCTION PROGRAM IS EXCESSIVE IN COST AND, IN VIEW OF LOW UTILIZATION RATES, OFFERS SIGNIFICANT OPPORTUNITIES FOR COST SAVINGS.

FOR EXAMPLE, THE SIX VA NURSING HOMES COMPLETED IN 1980 AND 1981 AVERAGED FOUR TIMES THE COST PER BED OF TWO PRIVATE SECTOR COMPANIES CONSTRUCTING NURSING HOMES IN THE SAME PERIOD. IN ADDITION, THE BRONX VA HOSPTIAL, COMPLETED IN 1980, COST $191,300 PER BED OR TWICE THE $97,400 COST PER BED OF THE DUKE UNIVERSITY HOSPITAL COMPLETED AT ABOUT THE SAME TIME.

OUR RECOMMENDATIONS INCLUDE THE DISCONTINUATION OF VA NURSING HOME CONSTRUCTION AND INSTEAD SUGGEST THAT UNDERUTILIZED HOSPITAL BEDS SHOULD BE CONVERTED TO NURSING CARE. CLOSE TO $600 MILLION OVER THREE YEARS COULD BE SAVED BY A DECISION TO STOP NEW NURSING HOME CONSTRUCTION. FURTHER, VA HOSPITAL CONSTRUCTION SHOULD BE PHASED-OUT AND INCREASED CONTRACTING TO THE PRIVATE SECTOR FOR BOTH NURSING HOME AND HOSPITAL BEDS SHOULD BE SUBSTITUTED. PHASE-OUT OF NEW VA HOSPITAL CONSTRUCTION WOULD SAVE $554 MILLION OVER THREE YEARS.

IN REVIEWING THE GOVERNMENT'S MANAGEMENT FUNCTIONS, WE NOTED THAT THERE IS NO CRITICAL GOVERNMENT ORGANIZATION RESPONSIBLE FOR DIRECTING AND COORDINATING FEDERAL ACCOUNTING AND FINANCIAL ACTIVITIES. AS A RESULT, THERE IS INADEQUATE AGENCY AND GOVERNMENT-WIDE FINANCIAL ACCOUNTING AND REPORTING; INCONSISTENT APPLICATION OF ACCOUNTING PROCEDURES AMONG AGENCIES; UNRELIABLE FINANCIAL DATA; DUPLICATE SYSTEMS DEVELOPMENT AND NO CENTRALIZED REPORTING OF RESULTS. THERE ARE, FOR EXAMPLE, OVER 300 INCOMPATIBLE ACCOUNTING SYSTEMS IN GOVERNMENT AGENCIES. INCIDENTALLY, WE FOUND THE COST OF ISSUING A PAYROLL CHECK TO BE ABOUT $4 IN TWO AGENCIES FOR WHICH DATA WAS READILY AVAILABLE, ARMY AND INTERIOR. THIS COMPARED TO A PRIVATE SECTOR COST OF ABOUT 75 CENTS TO $1.25. WITH MORE THAN 8 MILLION ACTIVE AND RETIRED MILITARY AND CIVILIAN EMPLOYEES, TENS OF MILLIONS OF SOCIAL SECURITY RECIPIENTS, ETC. THE EXCESS COSTS OF CHECK ISSUANCE ARE ENORMOUS -- THE TREASURY ESTIMATED MORE THAN 665 MILLION CHECKS WERE ISSUED IN 1983.

THE AVERAGE AGE OF GOVERNMENT COMPUTERS IS ALMOST SEVEN YEARS -- ABOUT TWICE THAT OF THE PRIVATE SECTOR. THE GOVERNMENT'S CURRENT FIVE-YEAR REPLACEMENT PLAN WOULD ACTUALLY INCREASE THE AVERAGE AGE OF THEIR COMPUTERS TO 10.1 YEARS.

THE ALTERNATIVE REPLACEMENT SCHEDULE RECOMMENDED BY PPSSCC WOULD REPLACE ALL COMPUTERS OVER FIVE YEARS OLD, REDUCE THE AVERAGE AGE TO 4.4 YEARS, AND RESULT IN NET SAVINGS OF $4 BILLION OVER THREE YEARS.

PROBLEMS IN FINANCIAL CONTROL LEAD TO PROBLEMS IN CASH MANAGEMENT. EACH YEAR THE GOVERNMENT SPENDS AND COLLECTS $1.7 TRILLION -- ALMOST $1 BILLION EVERY WORKING HOUR. YET, THE GOVERNMENT CANNOT DETERMINE ITS CASH BALANCE AT ANY POINT IN TIME. OUR RECOMMENDATIONS IN THIS AREA WOULD SAVE $23.5 BILLION OVER THREE YEARS BY:

- ACCELERATING GOVERNMENT TAX COLLECTIONS BY EARLIER SETTLEMENT OF TAX COURT CASES COULD SAVE $4 BILLION OVER THREE YEARS BY THE ADDITION OF 75 ADMINISTRATIVE LAW JUDGES.
- THE IRS HAS A BACKLOG OF DELINQUENT TAXES OF $23.2 BILLION. BY ALLOCATING IRS STAFF RESOURCES ON A COST/BENEFIT BASIS, INCREASING CLERICAL SUPPORT TO REVENUE OFFICERS, AND ENHANCING COLLECTION TECHNIQUES, $3.9 BILLION CAN BE SAVED OVER THREE YERAS.
- BY ADDING 2,500 TAX EXAMINERS IN EACH OF THE NEXT THREE YEARS, ADDITIONAL REVENUES OF $2.7 BILLION CAN BE COLLECTED. TAX EXAMINATIONS PRODUCE A DIRECT AFFECT ON TAX COMPLIANCE AND, WITH THE TAX GAP ESTIMATED AT $133 BILLION, THE OPPORTUNITY FOR ADDITIONAL COLLECTIONS IS SIGNIFICANT.
- BY SIMPLY PAYING BILLS WHEN DUE RATHER THAN ON A FIRST-IN FIRST-OUT BASIS, $1.3 BILLION OVER THREE YEARS COULD BE SAVED.

- ELECTRONIC FUNDS TRANSFER (EFT) CAN SAVE THE GOVERNMENT $1.6 BILLION OVER THREE YEARS. FOR EXAMPLE, ACCOUNT WITHDRAWAL ON INSTALLMENT PAYMENTS COULD SAVE $821 MILLION AND USING EFT TO COLLECT ALCOHOL AND CIGARETTE EXCISE TAXES COULD SAVE $294 MILLION.

AN ESTIMATED $250 BILLION WAS OWED TO THE FEDERAL GOVERNMENT AT THE END OF FY 1982. OVER $38 BILLION OF THAT WAS DELINQUENT OR IN DEFAULT, AND ALMOST HALF OF THE DELINQUENCIES WERE MORE THAN SIX MONTHS PAST DUE. ALMOST $2 BILLION IN BAD DEBTS WERE WRITTEN OFF IN FY 1982, AND AN ADDITIONAL $2.5 BILLION WILL BE WRITTEN OFF DURING THE NEXT 18 MONTHS.

THE FOLLOWING ARE AMONG OUR RECOMMENDATIONS:

- DEVELOP UNIFORM DEFINITIONS FOR TERMS SUCH AS DEBT, DELINQUENT DEBT, ALLOWANCE FOR DOUBTFUL ACCOUNT, AND WRITE OFF. GOVERNMENT AGENCIES ARE SIMPLY NOT SPEAKING THE SAME LANGUAGE AND, UNTIL THEY DO, CORRECTIVE ACTION IS UNLIKELY.
- ESTABLISH UNIFORM PROCEDURES, WHICH WILL INVOLVE CREATING SEPARATE CREDIT DEPARTMENTS IN EACH AGENCY.
- USE INTERNAL REVENUE SERVICE TAX REFUND MONIES TO OFFSET DEBTS OWED TO THE GOVERNMENT.

- USE PRIVATE COLLECTION AGENCIES AND CREDIT BUREAUS TO SUPPLEMENT COLLECTION AND CREDIT GRANTING EFFORTS OF GOVERNMENT.
- CHARGE INTEREST AND PENALTIES ON DELINQUENT DEBT.

THERE ARE, OF COURSE, MANY MORE RECOMMENDATIONS IN OUR TASK FORCE REPORTS, INCLUDING VERY IMPORTANT SAVINGS IN AMENDMENTS TO THE MILITARY PENSION SYSTEM AND THE CIVIL SERVICE PENSION SYSTEM.

THE RESULTS OF OUR EFFORTS PRESENT A VERY REAL OPPORTUNITY FOR A BIPARTISIAN INITIATIVE BY THE CONGRESS AND THE ADMINISTRATION TO JOIN FORCES IN REDUCING THE COST OF GOVERNMENT. DIFFICULT THOUGH IT MAY BE, THE CONSEQUENCES OF NOT CAPITALIZING ON THE PPSSCC "WINDOW OF OPPORTUNITY" ARE LIKELY TO YIELD EVEN LESS DESIRABLE ALTERNATIVES FOR THE AMERICAN PEOPLE.

ON A MORE POSITIVE NOTE, I WOULD BE REMISS IF I WERE NOT TO POINT OUT THAT MANY OF THE PPSSCC RECOMMENDATIONS ARE ALREADY IN THE PROCESS OF BEING REVIEWED FOR THE PURPOSE OF IMPLEMENTATION. INDEED, THE WHITE HOUSE HAS PUT TOGETHER A COMPREHENSIVE MECHANISM FOR THE PURPOSE OF REVIEWING WITH THE DEPARTMENTS AND AGENCIES, THE OFFICE OF MANAGEMENT AND BUDGET, AND THE OFFICE OF POLICY DEVELOPMENT EACH AND EVERY ISSUE CONTAINED IN THE TASK FORCE REPORTS. IN ADDITION, REPRESENTATIVES FROM PPSSCC ACTIVELY PARTICIPATE IN THOSE DELIBERATIONS.

OUR EFFORTS ARE BEGINNING TO PAY OFF, AS EVIDENCED BY TWO RECENT ARTICLES APPEARING IN THE WASHINGTON POST AND A NEWS RELEASE BY THE DEPARTMENT OF EDUCATION SHOWING EXAMPLES OF PPSSCC RECOMMENDATIONS BEING IMPLEMENTED.

A. A $4.7 BILLION SAVINGS FOR THE FY 1985 BUDGET THROUGH THE IMPLEMENTATION OF PPSSCC CASH MANAGEMENT IMPROVEMENT RECOMMENDATIONS ACROSS GOVERNMENT.

B. A REDUCTION OF 1200 FEDERAL EMPLOYEES FROM THE ROLES OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES AS IDENTIFIED AND RECOMMENDED BY PPSSCC, WITH AN ESTIMATED $172 MILLION IN SAVINGS OVER THREE YEARS.

C. AN INITIATIVE UNDERTAKEN BY SECRETARY BELL AT THE DEPARTMENT OF EDUCATION REGARDING DELINQUENT STUDENT LOANS, WITH INITIAL FOCUS ON 41,000 CURRENT OR RETIRED FEDERAL EMPLOYEES OWING MORE THAN $65 MILLION IN DELINQUENT STUDENT LOANS.

WHILE THE EARLY SIGNS ARE MOST ENCOURAGING, IT MUST CONTINUE AS MUCH, MUCH MORE NEEDS TO BE DONE.

I THINK, HOWEVER, I HAVE USED UP MY TIME AND I HOPE THE SAMPLES I HAVE CHOSEN GIVE THE COMMITTEE AN IDEA OF THE VARIETY OF RECOMMENDATIONS AND AN IDENTIFICATION OF SOME OF THE LARGER POTENTIAL AND POSSIBLE SAVINGS.

IT SHOULD BE EMPHASIZED, HOWEVER, THAT OUR RECOMMENDATIONS HAVE DIFFERENT DEGREES OF DOCUMENTATION AND THE SAVINGS, OF COURSE, ARE ESTIMATES. THEY SHOULD BE UNDERSTOOD TO BE OF A "PLANNING QUALITY" RATHER THAN A "BUDGET QUALITY." WE SIMPLY DID NOT HAVE THE TIME NOR THE RESOURCES TO DO DETAILED, IN-DEPTH REVIEWS. ACCORDINGLY, MANY OF OUR RECOMMENDATIONS WILL UNDERSTANDABLY REQUIRE FURTHER REVIEW AND ANALYSIS PRIOR TO IMPLEMENTATION. WHAT'S IMPORTANT, HOWEVER, IS THAT WE HAVE IDENTIFIED THOUSANDS OF OPPORTUNITIES FOR COST SAVINGS TOTALING BILLIONS OF DOLLARS A YEAR WITHOUT COST TO THE GOVERNMENT -- THE ENTIRE PPSSCC EFFORT WAS FUNDED BY PRIVATE SECTOR FUNDS -- AN AMOUNT NOW TOTALING IN EXCESS OF $75 MILLION.

AGAIN, I THANK YOU, MR. CHAIRMAN, FOR THE OPPORTUNITY TO ATTEND YOUR HEARING.

Senator **Armstrong**. I do not know whether my colleagues would agree with this, but I attend a lot of hearings and most of them are extraordinarily boring, and I thank you for an interesting presentation and, in fact, a provocative presentation.

In accordance with the early bird rule, Senator Gorton.

Senator **Gorton**. Thank you, Mr. Chairman.

COMMISSION REACTION OF DEFENSE DEPARTMENT

I would like to concentrate at this point a couple of questions, Mr. Grace, on your discussion of the Department of Defense. About half of your major recommendations fall into that category.

As you may know, there was considerable discussion in one quite celebrated hearing conducted by this committee last spring on precisely that subject and especially on the way in which the actual cost of procurement of new weapons systems grows so rapidly from the time at which a program is originally authorized to the time at which we actually have the weapons in hand.

Could you discuss in general your reaction and your studies of the Department of the Defense and explain to the best of your ability to do so why the Defense Department—and for that matter we in Congress, do not seem to have discovered and implemented those savings, the attitude that you received when your task force went into the Department of Defense and some of the reasons, in your view, for these constant and radical increases in weapons costs?

Mr. **Grace**. Well, insofar as the reaction when we went in there, I was utterly amazed to find throughout the whole Government that we were treated unbelievably politely and fairly and decently and honestly everywhere except for the Federal Home Loan. [Laughter.]

They refused to see us, and that is all right. It was small so let it go. But I was amazed. Everywhere we went, we were given rooms and facilities and questions were answered honestly. By and large this was very, very honest all the way through.

Now, I am not an expert in this regard. Mr. Larkin used to be General Counsel of the Defense Department under Jim Forrestal and General Marshall and Bob Lovett and Louis Johnson. There were four secretaries and he served them all as the General Counsel and with Admiral McNeal who was in charge of all the budgeting.

TENURE TOO SHORT

One of the problems as I see it is that there is too short a tenure of the people that come in. They do not have time enough because they are——

Senator **Gorton**. Are you speaking at this point of military officers or the civilians?

Mr. **Grace**. I am speaking of the professional people that come in, the Secretary of Defense, the Assistant Secretaries, the team that is brought in. In the first place, it takes them, as you know, quite a while to even educate themselves on what they ought to be doing, and then when they do that, they become quite captive to the people who were educating them. That is No. 1.

If I am ignorant and you are educating me, then I have a hard time going against you later because you taught me everything I knew. That is one of the problems.

Plus the fact that——

Senator ARMSTRONG. What is the answer to that problem? Forgive me for interrupting.

SYSTEM INADEQUATE FOR MANAGEMENT

Mr. GRACE. The answer to that problem is, in my opinion, in the first place, the Congress has got to let the Defense Department know that they are completely dissatisfied with the way the system works. It is wrong, wrong, wrong. I think there ought to be a group appointed to look at the systems in which they operate. In other words, the tie-ins between the suppliers and the people who are buying the stuff from the suppliers. This spare parts situation is ridiculous.

Many times a contract calls that you have to buy the spare parts from the same supplier. Yes, maybe we do, but here are the costs and prices and they will be escalated 5 percent or 3 percent but none of this 30 times which we have had.

In other words, it is nothing more than commonsense, Senator Armstrong, and it can be done, but the Congress has to let these people, these professionals that go into the Defense Department recognize that that just is not going to be allowed.

Again, I am not an expert on defense, the need for it, but it seems to me based on my knowledge of the world situation that we are going to be spending a lot of money on defense for a long time, unless the whole world blows up sooner than I think it is, and if that is true, then we have got to get to be more professional in how this thing is managed, and it can be done.

For instance, we could create, you could create, the administration could sit down and create with you a better overhead structure for controlling this thing. You take the Secretary of Defense. He is traveling a great deal. He is up on the Hill a great deal. In the last 2 weeks, what has he been involved with? With Lebanon and the islands in the Caribbean, et cetera? How much time has he got to manage the store? That is my question.

The system is inadequate for management. That is my view, and I think that is the main problem, Senator.

Senator GORTON. I believe in your testimony here you suggested in respect to weapons systems two things. One was longer term contracting and the second was fewer systems.

Mr. GRACE. And the third was keeping dual suppliers in longer.

CAUSE EFFICIENCIES TO TAKE PLACE BY APPROPRIATING LESS MONEY

Senator GORTON. Exactly. Now, do you believe that the Congress would be successful in causing the Department of Defense to make any of these institutional changes simply by cutting the amount which it appropriates for defense purposes? If the Defense Department had less money, would it use it more efficiently or would it be likely to use it less efficiently if Congress did not accompany that change with very, very precise instructions as to how the money was going to be spent?

Mr. **Grace**. I hope you do not mind if I give you an honest answer to that question, Senator.

Senator **Gorton**. I hope you do. [Laughter.]

Mr. **Grace**. I mean, it may step on some people's toes. But Congress is doing a lot of this stuff, too. In other words, we are going to have in our report coming out in the next month the number of excess basis that are existing. You have, for instance, no competitive bidding for shipping goods to and from Alaska and Hawaii, and that is $63 million over 3 years.

So what I mean is as long as the Congress is going to play footsy with this money, too, I mean, what kind of an example is it setting? I think everybody has to get together and be more honest and more decent toward these poor American taxpayers that I pointed out, these little people who have had a quadrupling in their tax rates.

I think when we recognize that these are the people that have the money; the 63 percent is the $11,400. We are taking money right out of these small people and blowing it here, and as long as the Congress blows it, these guys up in the Defense Department are going to blow it, too. Everybody is blowing it.

Senator **Gorton**. Mr. Grace, that was an honest answer and a good answer, but it was not an answer to the question I asked. The question I asked was whether or not we could cause some of these efficiencies to take place by appropriating less money or is it going to require much more than that, and a careful statement of sets of priorities on the part of the Congress itself in doing so?

Mr. **Grace**. I do not think appropriating less money would do the trick, Senator. I do not. I think that more time spent on it by honest people who are in their own bailiwick doing the kinds of things you want these people to do, then I think that is the most effective way to do it.

That was the point I was trying to make that two thieves cannot help each other much. But if one honest guy gets in there, he can lead the other guy to an honest form of approach. [Laughter.]

Senator **Gorton**. Thank you, Mr. Chairman.

MAJOR COMPONENT PARTS OF DOD OVERHAUL

Mr. **Bolduc**. Senator, let me see if I can shed a little light on that. I think you cannot really take a look at one piece of the pie without taking a look at the total pie. There are four major component parts of that pie as it relates to the Department of Defense that really need to be addressed.

One is strategy. The other one is the structure, the systems and the people. You need an integrated strategy not on the part of one service but on the part of the Department of Defense.

You need an appropriate strategy and an appropriate structure that integrates properly in order to assure the accomplishment of that strategy. You need management systems which are not there now and you have obsolete hardware and software as well, and most importantly, you need people who are incentized.

There is no incentive for a career official in Defense to try to improve that bottom line. It simply is not there.

Senator **Gorton**. Thank you.

LACK OF INCENTIVES

Senator **Armstrong**. Mr. Bolduc, could you just mention what kind of incentives you have in mind? I share your feeling but it is easy to say we lack incentives but it is hard, at least for me, to conceptualize what those might be.

Mr. **Bolduc**. Sure. Let us take a look at the private sector for a moment. There is a built-in incentive called the bottom line, and if one performs above and beyond a level of expectation, one is provided a bonus.

We are all aware of the Civil Service Reform Act that was passed in 1978. The system has worked with moderate effectiveness and in some parts of Government with very little effectiveness.

Why is it today that we have senior officials in Government, civil servants in Government, who run organizations of 10,000 to 15,000 people who are paid the same number of dollars as subordinates three to four to five levels down in that organization who are only responsible for their own actions?

There is no incentive for that person who is responsible for their actions alone with no supervisory responsibility to want to become a manager, to try to attract and motivate the best that the Government has to offer.

Why not take an individual who is responsible for a $100 million organization and say, "If you can improve the performance of this organization and return to the Treasury $15 million this year, we will give you a $25,000 bonus." This is what you would do in the private sector, but that incentive is not there.

SERIES OF DISINCENTIVES

There is a whole series of disincentives. That person gets paid the same number of dollars irrespective of how he or she performs, and he gets paid the same number of dollars irrespective in many cases of the level of responsibility that that person assumes.

Worse yet, we retire in the military side some of the most competent and most capable people after 20 years of service at a point in time in their careers. When they are learned and capable and willing to perform, we retire them and they get other employment, either in the private sector or in State government or elsewhere.

So the incentives are simply not there as they are in the private arena. I will not even address the other side in terms of attempting to remove somebody from the rolls.

You should also consider that on the military side you rotate everybody every 3 years. So if you take someone and you bring him into a highly technical area, one that we are all familiar with, data processing, and that person knows little about data processing, he is a military person. Once he is there 3 years and begins to understand what he is doing, he is rotated on to another assignment. There ought to be more bottom line oriented incentives.

Mr. **Grace**. And of course, you mentioned the disincentives. I do not know Chairman Chadd of the SEC, but he, when he put in shelf registration and a whole series of things that cutdown the paperwork load in the SEC, he was going to eliminate 125 people. And when that word got out, he was called up by the congressional committee with oversight responsibility. They said, "You are cutting your force by too much to carry out the legislated authorities that you have. You may not do that."

So that man could not do it, and now he is marked lousy throughout the whole Commission. So I mean the negative disincentives are tremendous. And in business, it is just the opposite. Everybody is praised if they do these things, and they get a reward for it.

PILOT PROJECT

Mr. **Bolduc**. I think one of the things, if this committee would do nothing else but to consider a pilot project that would take a look at an organization and bottom line what it has cost historically to carry out the services or the products that they produce or perform and provide an incentive based upon an evaluation of organizational performance and individual performance that would provide that if this organization can still deliver the quality of the services or the products that they produce as they have in the past more efficiently, more effectively, and more responsibly, that the number of dollars that are saved can be shared within the organization and amongst the individuals who have participated in saving those kinds of dollars. That is done in the private sector, and if you would see that, you would then see that individual earning $63,000 a year become motivated in the sense that there is some incentive to challenge that system, to challenge the practices of the past and to try to make it better for himself or herself and for members of that organization. It simply is not there now.

Senator **Armstrong**. I believe that Senator Metzenbaum was the next to arrive. Senator.

REPORT VOID ON BALANCING BUDGET

Senator **Metzenbaum**. Mr. Grace, it is nice to have you with us here this morning, and I find your report interesting, and as a matter of fact, I can agree with considerable portions of it, particularly when you get into some of the Defense spending and some of the nonbusiness-like manner in which many of their activities are conducted.

However, I feel that the report has a gaping void if we are really to zoom in on this whole issue of balancing the budget and in doing that which government ought to do, because you are a very successful business person.

Mr. **Grace**. I have not made as much money as you did.

Senator **Metzenbaum**. Hell you have not. [Laughter.] I am willing to trade places.

Mr. **Grace**. OK. [Laughter.]

Senator **Metzenbaum**. Regardless, both of us agree that if you want to run a business, you got to have the money coming in, and then you got to get more in and spend less, and that is the way you make a profit.

Mr. **Grace**. Right.

Senator **Metzenbaum**. Now, Government does not operate to make a profit, but it should operate to have a balanced budget.

Mr. **Grace**. Right.

CORPORATIONS BENEFIT FROM TAX SUBSIDIES

Senator **Metzenbaum**. I must say that I am concerned that your Commission, and maybe you felt it was not within the area of responsibility to zero in on the question of income. In all fairness, you did, in your report this morning, and I am sorry I came in late but I came in from out of the city, did talk about income, and I want to get back to that on personal income.

But I am concerned about the whole area of tax subsidies which are sometimes called tax loopholes, and I am concerned, for example, that corporations will receive more in tax subsidies this year than they will pay out in Federal income taxes, that in the first 6 months of this fiscal year Treasury collected $24.9 billion, that is, in the past fiscal year, in corporate income taxes, but it paid out $12.6 billion in refunds. In October, November, and February, refunds actually acceded receipts, and Treasury predicts that by the end of this past fiscal year, refunds will reach a record of $25 billion.

Now, I am concerned about these matters, and I am a realist enough to recognize that your Commission has some of the very people on it who are the greatest beneficiaries of some of the corporate tax loopholes that presently exist.

Bank of America, on the Commission, 1981, had earned $154 million in the United States, paid no Federal corporate income tax. Security Pacific Bank, on the Commission, 1981, had earned $165 million in the United States and paid no Federal corporate income tax. Bankers Trust, represented on the Commission, 1981, had earned $45 million, paid no corporate income tax. First Bank System, represented on the Commission, 1981, earned $69 million in the United States and paid no Federal income taxes.

Mr. Grace, could we agree that there is something that has to be changed if we make it possible for very successful corporations making good profits, failing to bear a fair share of their corporate responsibility to pay for Government operations.

Mr. **Grace**. I could not agree with you more, Senator. May I ask you? Where do you get that information? Is it public information as to which corporation, how much they made and how much they paid in income taxes?

Senator **Metzenbaum**. I am certain that it is. I am certain that these figures came from published information.

Mr. **Grace**. It is published information, because I did not know that you could get the tax return of different companies.

Senator **Metzenbaum**. I think that you cannot get the tax return but you can get their published annual reports.

Mr. **Grace**. Yes. But you can get the amount of income tax they paid?

Senator **Metzenbaum**. Oh, yes.

Mr. **Grace**. Usually these annual reports show income taxes, but they do not show which country they are paying it to. In other words, you see the total income taxes paid, but if they are internationally operated, you do not know where they paid it. So I have never been able to find the domestic tax payments of these big companies.

I agree with you. It sounds ridiculous, but, Senator, you are down here. You are writing the tax legislation. How the hell did this happen? I mean, what is the matter with the legislation? [Laughter.] I do not know.

LOOPHOLES DIFFICULT TO CLOSE

Senator **Metzenbaum**. I will tell you how it happens. It happens because there are extremely able lobbyists who work these halls, and it happens because there are those who would make an effort to close some of these loopholes, and with all due respect, I would say that those are not necessarily on my side of the aisle. I think that the present chairman of the Finance Committee is very much aware of many of these loopholes and would, indeed, like to do something about it.

It is only fair to say that he has had difficulty in being able to marshal the votes of Democrats and Republicans alike on his committee in order to do that.

But the fact is that he needs—you have as prestigious a Commission as almost any commission I have ever seen. You have the U.S. Chamber of Commerce, the Business Roundtable, and the National Association of Manufacturers all in one kit and caboodle, and if that group were saying this kind of thing, then maybe Senator Dole and others who feel as I do about the subject, and I am not going to say that he and I are in complete accord, but the fact is that the Joint Economic Committee, staffs of the Finance Committee recognize these loopholes do not make good sense and do not make for good government, and we need the support of a Commission such as yours. We need the support of the Peterson Commission or whatever it was called, and it was examining into some of the same subjects with respect to balancing the budget.

You have on your Commission, you have ARCO, Phillips, Exxon, Teneco, Mobil. Frankly, Mr. Grace, it does not make sense to run a government where some people get the right to write off all their expenses in the first year for intangible drilling costs, for example, and your company does not get that right, and General Motors does not get that right, and it does not make sense to permit a group of timber companies to be able to treat their product on a capital gains basis when they make sales, and all the rest of the farmers in this country, they do not have that privilege. When they sell their products, they pay at a full tax rate.

There are loopholes after loopholes after loopholes, and what bothers me about the Grace Commission report is not the thrust of where you are going—there are some parts that bother me and I will get back to it in a minute—but some portions of it, I think you are right on target.

But I think there is a gaping void where you do nothing about the fact that some segments of society, private as well as corporate, are not bearing their fair share of taxation, and that is where I have my problem with your Commission's report.

I would hope to gain the support of you and your whole Commission on this issue.

NO TIME FOR ANALYSIS OF TAX PROGRAMS

Mr. LARKIN. Perhaps I can cast a little light on that, Senator. Our mandate was to examine operations for waste, overlap, and so forth and so on, and basically find methods of cost control.

The problem was so large, the executive branch of Government, and I do not have to tell you, is so large, so complex, and the scope is so extensive that we had more than our hands full to just try to carry out the mandate we were given. So that we did not have time, nor did we attempt to do an analysis of the tax programs of the United States, the tax structure, the loopholes, and so forth and so on.

You are perfectly right. That is a subject of a very excellent study, but we just did not have the time to do it. That was our problem.

TAXABLE INCOME NOT A FAIR FIGURE

Senator METZENBAUM. Mr. Larkin, I appreciate that, and as you know, I did allude to that fact that that was not necessarily within the scope of your responsibility. On the other hand, I should point out that in Mr. Grace's report, he did address himself to the subject of taxable income and taxes generated from all taxpayers by bracket so that he opened the door to this question of tax revenues. Therefore, I felt it appropriate to discuss it.

Now, on that point, I want to ask, and I do not know who can answer this for me, whether or not, in that chart which is to be found on page 10 of your report,[1] and you talk about the fact that if you collected all of the money of the taxable income from the so-called rich you would only impact 4.1 percent of the total $805 billion Federal expenditure.

My question is, in taxable income, is it not the fact that you have totally excluded all of the tax-free income of the so-called high income earners and you have also totally excluded all of the sheltered income which many of those who are so-called wealthy have used and continue to use, and as a matter of fact, continue to invest in under the sponsorship of some of the very people who are on this Commission, like Merrill Lynch and some of the other investment banking houses.

So taxable income is not really a fair figure, is it? I mean, it is not really a fair description of the kinds of dollars that would be available. You have to talk about income as distinguished from taxable income, do you not?

TAX-EXEMPT BONDS BENEFITING THE WEALTHY

Mr. GRACE. Senator, on that, before you came this morning, we discussed $156 billion of so-called tax expenditures, and we have a complete study of that, and we have studied it by bracket. There are something like 60 elements on this sheet, and what we have done is we have spread them across all the brackets, you know, whether it be 7,500 or 12, right up through.

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[1] See p. 30.

Now, the only one that really is benefiting the very wealthy is the tax-exempt bond situation which has been carried on, as I said earlier, even to the building of a McDonald's, and I think it was in your State of Ohio where the McDonald's was built with a tax-exempt bond.

So this obviously is something that——

Senator **Metzenbaum**. I might say I offered an amendment to knock that out, because I do not think a McDonald's ought to be used.

Mr. **Grace**. Yes. But the point is that that is the one that really helps the wealthy.

Now, when we talk taxable income, Senator, we are talking what you people have made taxable. That is your business. If you want to make the interest on tax-exempt bonds taxable, this figure will increase, of course, and we know exactly how much money you will raise and from what brackets, and we know how much money you will raise with the deductibility of home mortgages, charitable contributions, all of them.

We have the whole list and we have it spread out by brackets, and the only one that will really not hit roughly the same percent, when we say here that 90 percent of the cumulative taxable income comes under $35,000, you will find that in 58 of the 60 so-called tax exemptions, except for the tax-free interest on municipal and local government bonds, it is spread exactly the same way, and the bulk of this is in things that have been in existence, Senator, since 1913. Many of them have been in existence forever.

TAX SHELTERS ZOOMING UP

Senator **Metzenbaum**. Mr. Grace, I want to point out to you that I think it was yesterday's Washington Post which I did not see but I am told about, indicated how the tax shelters are now zooming up in amount at an unbelievable rate.

Mr. **Grace**. They are.

Senator **Metzenbaum**. And what has happened is, under that tax law that we passed, if you own an old building and I sell it to you, you start with a new tax basis of 15 years of accelerated depreciation. You do not add anything to the economy.

Mr. **Grace**. Yes, you sell it to me, but you had to pay a capital gains tax on that. So you paid a tax, and I felt very sorry for you before I bought it. [Laughter.]

Senator **Metzenbaum**. I know, but, Mr. Grace, I do not have to pay a capital gains tax if, at the same time, I buy a building from Mr. Bolduc and I use the tax shelter from that building in order to shelter the gain that I make as a capital gain.

So I would say to you that it is not very difficult if you have good tax lawyers today to find a way not to be paying taxes.

MORE PEOPLE TRYING TO AVOID PAYING TAXES

Mr. **Grace**. Do you have any idea how much this amounts to? I happen to agree with you in large part of what you are saying and I am not arguing. But have you any idea how much this amounts to compared to the underground economy?

The underground economy is $133 billion this year, and what you are talking about is a flight from paying taxes. I could not agree with you more. People are fed up to here paying taxes because they know that you are taking $408 billion and transferring it to other people in this country, and they do not like that.

They do not want their money to be blown. It was only $30 billion in 1965, and now it is $408 billion, and it is going to be $1 trillion in the 1990's, and they do not want their money taken like this.

These are people that I know who make $40,000, $45,000, truckdrivers, people who drive across the continent. We have a truck company of our own. These guys make big money. They and their wife drive across the country. They do not want their dough taken on $408 billion.

So you have got everybody from truckdrivers to rich people finding every damn way they can to avoid paying taxes. They are not like you. You are a very public spirited man. [Laughter.]

Senator **METZENBAUM**. Thank you. I quit. That is enough.

Senator **ARMSTRONG**. Let the record reflect that that observation was greeted with peals of laughter—[laughter]——

Senator **METZENBAUM**. Purely a matter of interpretation.

Senator **ARMSTRONG** [continuing]. Which were inexplicable to the acting chairman who also considers the Senator from Ohio a very public spirited man.

We have three Senators who have not had an opportunity to ask questions.

Senator **METZENBAUM**. I have more questions.

Senator **ARMSTRONG**. We will have a second round when everybody has had a chance.

Senator **QUAYLE**.

REFORM JOINT CHIEFS OF STAFF

Senator **QUAYLE**. Thank you, Mr. Chairman.

I would like to go back to the defense issue for a moment. I believe, Mr. Bolduc, you talked about defense regarding the formation of strategy, procuring the weapons to fit the strategy plus the personnel and then the overall management of that.

I wonder if you looked into defense expenditures and some of the criticisms from a management point of view, such as you raised in Mr. Grace's testimony, when you looked at the issue of reorganizing and reforming the Joint Chiefs of Staff. There has been some discussion in military circles about this matter and I am sure that you probably picked this up during your deliberations. I would like to know how much you looked at this as a potential for management reform. There is now criticism about the way in which the Joint Chiefs of Staff is managed. As a matter of fact, a number of former Secretaries of Defense, most recently Jim Schlesinger, came out and said that the organization of the Joint Chiefs of Staff needs to be reformed because each one of the services gets whatever they want. The services come forth with their wish list. There is no incentive from a career orientation, as Mr. Grace was talking about, for the people that are on the Joint Chiefs of Staff to say no because the are going to have to be reassigned back to that respective service. In fact, if they have not stood up for the Army or the Navy or the Marines or the Air Force, they are probably going to be received with less favor then when they went in there.

I wonder what kind of work and what kind of thoughts that you had on strengthening the position of the Chairman of the Joint Chiefs of Staff to perhaps make it somewhat more independent in order that the Chairman may overrule at times his peers on the Joint Chiefs of Staff. There, I believe, we have some duplication of effort.

You talked about the bases, Mr. Grace, or the commissaries. You observed that each individual service has got to have their own way. I wonder if you have looked into this extensively. You did not suggest it in your formal testimony, but I would like to hear any comments you may have on reforming the Joint Chiefs of Staff in regards to management and to the potential savings therefrom.

Mr. **Grace**. I would like Mr. Larkin to answer first.

STRUCTURAL WORK NEEDED ON ROLE OF JOINT CHIEFS

Mr. **Larkin**. Senator, we really did not look into the structure and the operation of the Joint Chiefs themselves. I happened to be on the scene when the National Security Act was passed in 1947, and Secretary Forrestal, who became the first secretary, as you know, invited me to join his staff there, and I did become the General Counsel until such time as General Marshal left.

We had great difficulty in the beginning trying to start a unification process between the three services. They had their own traditions, their own history, their own customs.

Progress was made, I think. We came up with the Uniform Code of Military Justice. We came up with a coordinated legislative program.

I am not too current since those days on what has been happening, but I seem to detect that there still is a great deal of structural work that needs to be done on the role of the Joint Chiefs, on the authority of the Secretary of Defense. We tried to steer our legislation in my day to the Secretary of Defense with authority for him to redelegate whatever he thought appropriate to the Secretary of the Army, Navy, and Air Force.

It appears to me that a great deal of structural work of that kind, or organizational work, is really needed. I would be so bold to say that perhaps a Hoover style commission looking at organization and structure is an appropriate kind of commission to do that study.

Our study was basically operations, cost control, savings, possible savings. The first Hoover Commission, as you recall, did not get into much of that. They did get into some structural studies.

There are any number of studies since that time on all kinds of structures, on the Office of the President for that matter on how it operates or should operate.

But getting back to your point, I think there are really problems in the philosophy of the Joint Chiefs of Staff that each member of the Joint Chiefs is representative of his own service and is he trying to promote the future of his own service or is he really an overall overseer in partnership with others for the whole Department of Defense. There is an inherent conflict of interest in that type of organization, I think, the way it is today.

Senator QUAYLE. So you really did not get into this as far as any kind of structural changes that might lead to management efficiencies, particularly the way the recommendations come up from the various services to Secretary of Defense regarding what weapons we are going to have or what kind of a strategy we are going to use. This is one of the key points of discussion that we are going to examine in the military. I am curious if, in fact, you have any light to shed on possible structural changes. If not, that is fine.

Mr. LARKIN. We did not. We carefully stayed from strategy, the military strategy.

Senator QUAYLE. I am not talking about strategy because once a strategy is defined, you must go ahead and procure the weapons, et cetera, to fit the strategy. I was concerned if you looked at the various management or structural changes because you mentioned commissaries in your testimony. Also in response to Senator Gorton, or someone, you talked about base closings.

This all points to the parochialism that a lot of people believe is within the various services, and I just wondered how in depth you were able to observe this so-called ingrained inherent feeling in which each service has to have their own facilities. And that, because of this, communications and coordination between different services are lacking.

Now, if you did not observe this, that is fine. I was just curious.

RECOMMENDATIONS PROVIDED TO DEFENSE DEPARTMENT

Mr. BOLDUC. Senator, while we did not specifically address the Joint Chiefs of Staff issue, we did, in the Office of the Secretary of Defense report, spend a great deal of time discussing and providing recommendations about the fact that is readily obvious that the intent of the Department of Defense at the time it was organized has really not been achieved, that you really still have effectively three separate departments of defense rather than one.

We do provide recommendations. For example, we recommend that the Under Secretary for Acquisition Policy be split between R&D and acquisition so that you have a different screening and review process that takes place within the Office of the Secretary of Defense before a final decision is made, for example, with regard to a major weapons acquisition.

With regard to military bases, we did recommend the establishment of a bipartisan committee from the outside to take a look at this issue, because we are convinced that that issue cannot be resolved within the political parochial strains that currently exist within the DOD environment.

We had several recommendations dealing with organization within the Office of the Secretary of Defense and within the respective departments but not addressing the Joint Chiefs of Staff per se.

Mr. LARKIN. One other example, for instance, Senator, which will illustrate this problem is that each of the services have their own hospital system, and there is very little cooperation between them, very little sharing of equipment, so forth and so on. The hospitals are occupied, I think, about 48 percent.

Mr. BOLDUC. Forty-six-percent vacancy rate.

Mr. LARKIN. So this is symptomatic of the fact that they each go their own way in an essential of this kind. There are many savings, in our opinion, if they could be coordinated or if they would share their equipment, and so forth and so on.

Now, that seems to me is a factor of the control of the Secretary of Defense or his authority in those kinds of issues. However, there are many cost control items in this huge complex Government that we did not even get at under our own mandate. Unfortunately, we have had very little time to do anything else.

FEDERAL MANAGEMENT SYSTEM REPORT

Senator QUAYLE. Let me expand the management issue in question, going beyond the Department of Defense and looking at the other agencies as well.

Is there any generic piece of legislation that would address a management problem which the Congress should specifically examine? Is there one sort of a management tool that the Congress should be considering to give to the executive branch in order to reduce possible duplications in management?

Mr. GRACE. Well, the Federal management system report. We have a complete report that answers that question, Senator.

Mr. LARKIN. Yes, we do have a report. One of our task force studies addresses itself to the need for a Federal management system within the Government reporting to the President, almost a chief operating officer, if you will, and a chief financial officer, chief personnel officer, and executives of that kind.

Symptomatic of what you are saying is the situation we found when we started the President's private sector study. We started to look at the different studies that had been made. The GAO, of course, your own agency, has made numerous recommendations in all departments. As a matter of fact, they publish books this thick of the recommendations they have made in each of different departments which have not been accepted, have not been adopted. They have not been implemented.

So what we did, we gave those reports to the different study groups and said to the State Department study group or the Interior or Labor or whatever:

> Here is what the GAO said should be done in that department. Here is something for you to start with.
>
> Now, maybe their recommendations are not practical. It would be interesting to know why they have not been implemented. Why do you not check and find out why the department did not implement them? There may be a good reason. If there was not a good reason, why, we would suggest you rerecommend them.

That is why many of our recommendations have been identified before, but the point, if we get to it finally on this example, is we feel there is not enough managerial talent to have implemented those previous recommendations. If there had been, there would not be any need for us.

MANAGERIAL TALENT LACKING TO IMPLEMENT RECOMMENDATIONS

Senator **Quayle**. Do you think the main reason is that they simply lack the managerial talent to implement the recommendations?

Mr. **Larkin**. I think so and the need for people with the requisite authority.

Mr. **Grace**. That plus the incentive system and the disincentive system. I mean, the disincentive system is more important than the incentive system. You just do not get anywhere being a skunk at a garden party down here. On the contrary, you get much more popular if you do not make any enemies. You are here for a short time. I am not talking about Senators and Representatives. I am talking about people in the Government.

Senator **Quayle**. We are here for a short time, too, some shorter than others.

MANAGEMENT PROBLEMS IN EXECUTIVE BRANCH

Mr. **Bolduc**. Let me give you a very quick overview of the kinds of things I think that this committee and the Congress could be instrumental in effectuating, and let us start with the Executive Office of the President.

There are over 50 people reporting to the President himself. No matter how powerful, how efficient, and how effective a manager is, you simply cannot have 50 people reporting to you and be effective in the discharge of those responsibilities.

If you take a look at how the executive branch of Government is organized, you have Mr. Devine who is the Director of the Office of Personnel Management reporting to the President.

You have Mr. Carmen reporting to the President as Administrator of the General Services Administration. You have David Stockman reporting to him in terms of Office of Management and Budget.

If you take a look at the elements of effective management, you must be able to oversee and control people, dollars, resources, and systems, and yet the Office of Management and Budget which historically has been more budget than management does not have oversight responsibility over personnel, does not have oversight responsibility over the acquisition of computer hardware, real estate, plant facilities, property, et cetera.

So we recommended that those separate functional areas of management be brought under the control of one person so that they could be effectively integrated. For example, the Government handles, as Peter mentioned earlier, $1.7 trillion a year and there is no chief financial officer in the Federal Government.

Therefore, it is no wonder that you have 332 incompatible accounting systems, 319 different payrolling systems. Payrolling people is payrolling people is payrolling people. Why do you need 319 systems?

Nobody is in charge of cash flow management. Treasury has the responsibility but they do not have the authority to effectuate change; therefore, it flounders.

We have a special report titled "The Federal Management System" that has several recommendations dealing with the structure, the strategy, and the system of managing in the executive branch of Government.

Mr. **Grace**. And they are very, very important, Senator. I mean, if some of those things were done, you would correct a lot of these problems.

OPTIMISTIC ABOUT RECOMMENDATIONS

Senator **Quayle**. Let me just ask one final question, Mr. Chairman, then I will yield. Mr. Grace, as Mr. Larkin pointed out and as you well know, there have been a lot of other reports similar to this. Many previous findings are being reiterated in the Grace report. Many points are being emphasized again that were not implemented in the past.

In view of this, I would like to know two things. First, what is new and bold about the Grace initiative or Grace report that has not been reported in the past? Second, are you optimistic that some of the recommendations made in the Grace report will be implemented this time?

Mr. **Grace**. Yes; I do. And what is new about it is, as you know, Senator, everything in this world is timing, being at the right place at the right time, and you are running into a situation where the deficits are going to be in the $600 billion range in 6 or 7 years and $2 trillion in about 16 years.

So they have to be addressed. In other words, we used to get worried about $3 to $6 billion deficits but when you get to $195 billion running toward $300 to $400 billion, you have got to address it.

These reports are ageless. It does not make any difference if they are addressed next year or in 1985 after we have the election. The point is that it is 9 to 12 times what we are recommending in 6 years, and 29 to 51 times in 12 years. That is the cost of not doing what we are recommending, because now every nickel you spend is going to be subject to inflation and interest costs, a total of 16 to 20 percent a year, whichever you want to take the inflation and interest cost rates at.

So, what I say is we were asked at the right time when the country was heading for a major fiscal crisis, when we are turning over not $1.4 or $1.6 trillion debt ceiling argument that is going on, because the total debt when you get the off-budget stuff and the unamortized future pension contributions, it is somewhere around $4 trillion. We are turning that over to my 9 children and 12 grandchildren. It is a scandal. You are a young man. You are part of the next generation.

But no generation in the history of this country has come anywhere near turning over to future generations the financial problem of this kind. And, I am sure that if all of this is spread out across the country on television, in newspapers, and so forth, and they realize the amount of waste down here and the lack of administrative discipline, that the American people are going to demand a solution.

And, I think that is the difference, and I am very optimistic.

Senator **Armstrong**. Thank you, Senator Quayle.

Senator Chiles is optimistic and has questions. [Laughter.]

OFFICE OF FEDERAL PROCUREMENT POLICY

Senator **Chiles**. We talked about some earlier commissions. We had one called the Procurement Commission. It met for about 3 years in the early 1970's. I had a chance to be one of the congressional representatives on that.

As a result of that Procurement Commission, we created the Office of Federal Procurement Policy, the OFPP, and its job was to try to bring some coordination into this procurement. You set forth that it has gone from $20 to $160 billion. I remember we were talking about it being $60 billion at the time, of how big that it was in the early 1970's when we were talking about the need for the Office of Federal Procurement Policy.

We are in a dispute right now. It is on sort of a 3-year sunset so it has to be reorganized every 3 years, and after the first 3 years, we took away any sort of real management authority, and said it had purely advisory authority, because there was a little conflict run-in when the Office of Federal Procurement Policy got in between trying to settle a solution between the Department of Labor and the Department of Defense and trying to bring it to a head where a President or someone could make a decision on it.

Well, Defense did not like that at all, and neither did Labor for that matter. Each wanted to be able to go their own separate way as they always had, and so as a result of that, they struck the authority.

The recommendation now is to give back some management authority, not have it purely advisory, have it be as it was created to be, and as the Procurement Commission recommended some focal point in the Government that you can get some uniform procurement policy, that you can look at all of the areas, and as you know, Defense had their own separate procurement. They do not want to buy anything like anybody else, even though they are buying the same items, and many of the items that they are buying are exactly the same that we are buying in the Government.

But we got all these different kinds of procurement. Well, now we are seeing that Defense is saying, "if you give this kind of authority to the OFPP, you destroy the national security."

MAN WITH CLOUT IS NEEDED

How do we get around something like that where we are going to have these management tools, because when I see certain things you have recommended like how we are going to do with veterans hospitals or the commissary, you know, I recognize the kinds of problems you are going to have but if we cannot even deal with something like giving OFPP some real authority, we are never going to touch the surface of some of these other recommendations?

How can your group or how can we get some support to really do something?

Mr. **Grace**. Well, what kind of a man do you have as head of that authority and how much clout does he have and how smart is he? It seems to me that is an underkill job. If you look at our Federal management system report, Senator, you will see that what we are talking about is putting in place the kind of a control organization for managing the Government that you find in corporations where there is a management financial officer and things like that so that these things are brought to the attention of people on a constant basis, and the kind of people that will be in these jobs would be big people who could fight a guy like Secretary Weinberger.

In other words, if you have people who he can kill before breakfast, you are not going to get anywhere. You know how political clout counts, and you are a very tough guy. When you address something, you get what you want.

Senator CHILES. Well, you raise a very valid point on the clout area, and I will overlook the other thing you said. I never win anything around here hardly. [Laughter.]

OMB CAN GIVE OFPP CLOUT

On the other area, one of our big decisions was where we were going to house this. It was supposed to be a separate agency. We finally decided we had to put it under OMB because that was the only way to try to give it any clout. It would have been one more separate agency reporting to the President which we know would have gotten no clout whatsoever.

So we had to put it under OMB, but even in that, of course, it has been a problem. I do not know whether we are going to ever be able to create somebody, a czar that is going to rank with the Secretary of Defense, unless we are going to create a cabinet post for this manager that you are talking about.

Mr. GRACE. Well, we will send you a summary, Senator, of our Federal management system report. We are going to have a chief financial officer in the Government just like you have in a corporation, and the chief financial officer in a corporation cannot impede the activity of a very good operating officer, but the CEO, the matter is brought to his attention.

There are a number of systems that work. Now, you take a company. We started when I became president as a little shipping line for the few textile factories in South America. Now, we are a big, major international corporation with 80,000 employees.

We have reorganized our management structure about seven times. As this Government goes on, as you said, you were at $60 billion——

Senator CHILES. I thought you used to dig a little phosphate rock in Polk County. [Laughter.]

Mr. GRACE. Well, the phosphate rock, I wish you could buy it from us because the Export-Import Bank just financed Morocco to expand their production and they are going to kill Florida, but that is another issue.

But the point is that you really have to have a management structure that can work. And now that the Government is so big, you know, you mentioned the $60 billion versus the $160 billion when you were looking at it in the early 1970's. You have got to constantly reorganize the Government just like you do in corporations so that you have the clout where it belongs in a management system. That is why the most important report we have written is the Federal management system report.

If this is adopted, I will guarantee you, if it is staffed properly, and there is no reason why it cannot be, that this will solve a lot of the problems you are talking about.

LACK OF POWER BASE PROBLEM TO OFPP

Mr. Bolduc. Senator, specifically with regard to OFPP, the problem that OFPP has had is that it has no power base.

Mr. Grace. That is right.

Senator Chiles. I recognize that.

Mr. Bolduc. Now, if you take the role OFPP should be doing, OFPP should be a policy development, policy monitoring organization and not get involved with the day-to-day management operations of the respective agencies.

Senator Chiles. I agree with that.

Mr. Bolduc. Now, with that, what has got to happen is that the M in OMB must become reenforced and the way to make it work, you know, the power bases in town, when you are on the management side in this town, you are not as powerful as the program managers. Therefore, you have to use what is at your discretion, including the power base of assigning parking spaces if you have to.

What it means in terms of OFPP is that it must become an integrated process as part of the budget review, so that if you have an agency that fails to come into compliance with good, effective procurement policies, they are not going to get the kinds of dollars they need to support their procurement program when they make the day-to-day policy decisions at OMB for the next year's budget.

Right now, it is running two parallel tracks, and they are not integrated. Management must become integrated as part of the day-to-day budget decisionmaking process at OMB, and not have them go up this way and then Felix mentioned earlier, findings and recommendations that are not being implemented, those unanswered recommendations from GAO should be part of the budget decisionmaking process that if you did not address the $50 million savings in this program last year you ought not to get what you are seeking this year. If you did not implement a financial management system to find out what your overhead costs were, as you said you were going to do, you ought not to get support for that program this year.

That is the only way I know how OFPP can work. It is to put some pizazz in that decisionmaking process which is not there now.

Mr. Grace. Well, the OMB, in the first place, Senator, cannot do the job it should be OB and have another management situation. It is way beyond.

Senator Chiles. It has been OB. It has not been OMB. That is a misnomer to have had the "M" in there because it simply has not been that way.

Mr. Grace. Exactly. I mean, they did not even know when we came down to Washington, how many social programs there were. We started asking questions when we first came down here, and we could not believe the lack of knowledge in the OMB, and it is not an attack on any one person.

They work terribly hard. I mean, I have nothing but respect for the individuals, but the system is wrong.

SUPPORT EXPECTED FROM ADMINISTRATION

Senator **Chiles**. Well, let me ask you this. What kind of support do you sense that you are going to get from the administration in this management process?

Mr. **Grace**. Plenty.

Senator **Chiles**. Well, I am delighted to hear that now. I am wondering what happens when it starts to clash with the Secretaries, because that is where you will see the in-fighting really take place.

Mr. **Grace**. You are absolutely right. But we got to talk to the President personally about this and explain exactly that, and I am sure that he will be sympathetic to it, because he said to me the first day in Los Angeles. "Pretend you are going to merge with these people. Go in and see what changes you would want." "Mr. President, here are the changes, and they are essential." And I think that he will give a lot of support to them.

Now, whether he will do it in the middle of Grenada and Lebanon and an election coming up—I do not know who is going to be elected next year, but whoever is elected next year, they got to address themselves to these problems and these ideas.

And if he is reelected, I am certain that they will be addressed in a very sensible fashion.

Senator **Chiles**. Well, I hope they will be addressed. My fear is that there is always a Grenada. There is always one of those other issues that is there, and trying to do something like this which is even harder than some of these policy changes that you have to make, because it is harder to line up sort of support and get it to happen, especially when phone calls are made by a Secretary or someone else and saying, "We just could not live with that" or "you have to make this change". I hope you will persist in that.

Mr. **Grace**. Thank you, Senator.

COMPOSITION OF COMMISSION TASK FORCE

Senator **Armstrong**. Mr. Grace, could you take a moment to tell us about the composition of the task force? How many people are on it? And who are they in a general sort of way?

Mr. **Grace**. Well, there were 161 members of the executive committee, and then there were a total of 1,500 people altogether that worked here at one time or another on the studies.

The 161 people that were members of the executive committee, we have a complete list of it. They are the heads of most of the major corporations in the United States. As Senator Metzenbaum said, you have the Bank of America.

Senator **Armstrong**. How were they selected?

Mr. **Grace**. Well, they called me Lucky Eddy, and I just went down the Business Week and Fortune, and I looked at all the companies that were really doing things, the movers and shakers, and I suggested that we get as many movers and shakers down here as we could find.

There were people that turned us down, but most of them said, yes, Senator.

Senator **Armstrong**. In other words, you selected them?

Mr. **Grace**. Yes, sir.

Mr. **Larkin**. I think, Peter, you should recognize that the White House suggested a number of them as well, but Peter carried the biggest burden on that.

Senator **Armstrong**. Bipartisan group.

Mr. **Larkin**. Yes.

Senator **Armstrong**. Or a nonpartisan group.

Mr. **Grace**. Yes, but basically it was to look at how they ran their companies. Were they movers and shakers?

SELECTING TASK FORCE CHAIRMEN

Senator **Armstrong**. How were the task force chairmen selected?

Mr. **Grace**. Well, that was a long process. What we did is we tried to, say we had 100—at the time we were selecting the executive committee members, we probably at the time we made the task forces only had about 100 of these executive committee members.

So what we did was to try to put people in areas where they knew something about it. As you may have read in the press, we put Frank Carry, who was the CEO of IBM, into the computer situation on the theory that a man of his integrity plus the fact you are operating in a goldfish bowl would merely come up with a massive amount of intelligent analysis of what is wrong. We knew they were all obsolete and we knew they were too old.

But of course, he was stripped out, and all the way through, anybody who had any potential conflict of interest, the White House told us we could not put them in these jobs. That took 3 months to do that.

What we tried to do, and I will tell you what I tried to do, was to match the need with the knowledge, because I think that in this country, we are so assiduous in protecting conflicts of interest we wind up with all the dummies who do not know a damned thing.

Will Rogers used to say, "Everybody is stupid except on different subjects." And I am a great believer in that. And if we put the smart people in the subjects they know something about, we have a chance to do it. That is what I tried to do. I was frustrated on every turn by the White House legal.

So we wind up with a lot of people in things they did not know a damned thing about, but they tried to learn it.

TIME COMMITTED TO EFFORT

Senator **Armstrong**. In general, how much time would the chairman of a task force or the member of a task force commit to this effort?

Mr. **Grace**. Why do you not answer that, J.P.? You were working with them closer than I was.

Mr. **Bolduc**. It varied a great deal, Senator. We had some that played clearly a more active role than others, but I would say that on the surface that they probably devoted a couple or three days a month to the effort.

Senator **Armstrong**. Over what period of time?

Mr. **Bolduc**. Over at least an intensified period of 6 months and then sporadically thereafter depending on whether their task force effort was completed or went on beyond the 6-month effort.

Senator **Armstrong**. So that, in general, when we pick up a task force report, we could evaluate that that represents somewhere between 12 and 20 days of effort by the members and the chairman plus the staff days. Is that what you are saying?

Mr. **Larkin**. No. Talking about the members on the staff, these 160 executive committee members, 100 of whom were assigned as cochairman to the different study groups, two or three or four, depending on its complexity, because of the fact that they all had full-time jobs anyway, we recognized that one man could not be down here all the time so they kind of spelled each other week after week over the period.

They, in turn, recruited the 1,300 additional people who were assigned to the different study groups or task forces. It was these people who did the basic examination. They worked virtually full-time for 2, 3, or 4 months.

Senator **Armstrong**. I understand that, but the actual members of the executive committee who, as I understand it, comprised the task force members——

Mr. **Larkin**. Cochairman, yes,

Senator **Armstrong** [continuing]. Actually devoted 2 or 3 days a month for 6 months.

Mr. **Bolduc**. But that does not necessarily mean in Washington. They met at their own offices.

Senator **Armstrong**. I understand.

Mr. **Grace**. If there were 4 or 5 on an individual task force, 2 or 3 days a month added up to 10 or 15 on the combined basis. You see what I mean?

Senator **Armstrong**. In other words, each of them 2 or 3 days a month over this period.

Mr. **Grace**. Yes.

PROJECT MANAGERS VERY DEDICATED

Mr. **Bolduc**. I think, Senator, one additional point of clarification. One of those cochairs in the task force appointed a project manager, and that project manager was usually a senior officer within that person's firm. We have, for example, the chief financial officer for USA-Exxon, Cliff Garvin's person, a fellow by the name of Ed Robinson, he was the project manager on the procurement task force. We had Bill Tramain, the senior vice president with Prudential on the Office of the Secretary of Defense task force.

So there were very senior people. These project managers were 100 percent of the time in Washington dedicated to the day for 6 months and beyond.

Senator **Armstrong**. That is what I wanted to get to.

Mr. **Grace**. That is the key point.

Senator **Armstrong**. Forgive me for rushing, but I have a number of questions, and I want to get them in the record as quickly as I can.

I would like to ask you to take a look at pages 17 and 18 of your statement,[1] Mr. Grace, not because there is anything unique about it, but because on those 2 pages are some savings estimates.

For example, in the middle of page 17, you mention that more than $3.4 billion could be saved over 3 years by the more extensive use of dual sourcing, and on page 18, you mention a $7.2 billion saving from implementing a standardization, a cross-service standardization process.

METHOD OF ARRIVING AT ESTIMATES

My question is this. How did you arrive at those estimates? You mentioned that we could have confidence in them but we should not regard them as precision numbers. How were those estimates derived, not necessarily those particular estimates but all of them in these reports?

Mr. GRACE. Well, I think that since Mr. Bolduc was managing the office and dealing on a daily basis with the project managers and with the desk officers—we had a very strict checking system so that they would be certainly not crazy but not of a budget quality, more of an estimate quality. You might say how you arrived at those.

Mr. BOLDUC. We had, as Peter indicated, Senator, we had a group of 12 desk officers who were from the larger consulting firms in Washington who donated their services pro bono who were responsible to oversee the quality aspects of 3 task force reports on an ongoing basis, and they worked about 12 months from beginning to end.

The savings that we have were derived from—we attempted in each and every case to use a source document to define the size, the scope, how big, how short, how fat, how tall, was this particular issue.

We used CBO numbers. We used GAO numbers. We used inspector general numbers. We used the Office of Management and Budget numbers.

Mr. GRACE. And we checked it out with the departments and agencies before, right?

Mr. BOLDUC. In many cases, we went to that agency and we said, as it relates to dual sourcing, we went to the agency and said, "Is it true that our estimate that you procured *x* number of billions of dollars of these kinds of goods and services is in the ball park?" Having gotten confirmation of that number, we then attempted to locate specific examples where dual sourcing had, in fact, been carried out and calculated the potential savings that existed from actual empirical data, and using that as an indicator, talked to several people about whether it was in the ball park or not and then extrapolated that to the entire universe.

That is one way in which we did it. In other cases, we used statistics——

Senator ARMSTRONG. Does the written report discuss the estimating procedure in detail?

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[1] See pp. 37 and 38.

GOVERNMENT LACKS INFORMATION

Mr. **Bolduc**. It varies from case to case, where we felt it was necessary. For example, and in many cases, I must acknowledge that while there is a lot of data in Government, there is very little information.

For example, we will release a report tomorrow dealing with the three basic wage setting laws, Davis-Bacon, Walsh-Healey, and Contract Services Act. There is no information anyplace to determine the impact that those acts have upon Government.

So we interviewed numerous numbers of people, looked at records, arrived at extrapolations, and we explain in there how we came up with those numbers.

Mr. **Grace**. And I think that if there is any question, Senator, as to any individual like the ones you are saying here, we will be glad to provide that in writing. We have nothing to hide at all.

Mr. **Larkin**. There is another aspect that I think should be understood, Senator. The 3-year estimated savings do not mean this year, next, and the third year at this point in time, because we do not know when or if ever any one recommendation is going to be implemented, and when it is, then a 3-year period starts to run.

Senator **Armstrong**. I understand. It could be the year 2010.

Mr. **Larkin**. That has been confusing people, saying, "Oh, you are crazy. You cannot do it in the next 3 years." Well, we have not said that it is going to be in the next 3 years.

Senator **Armstrong**. I think we understand that, Mr. Larkin.

Mr. **Bolduc**. I think it important to point out one additional thing. In addition to the 300- or 350-page report that you now have, there is an appendix behind each one of those reports with the exception of six that goes 500, 600, 700, 800 pages that provides an audit trail from how we came to the numbers from the very source documents we have, and then there is over 1 million pages of work papers that are available to show that as well.

Senator **Armstrong**. Am I correct in assuming that if committees of the Congress wanted to have hearings on individual reports that your project managers would be available?

Mr. **Grace**. They are all available. We have them all on tap, Senator.

TALK OF SELLING PMA'S

Senator **Armstrong**. That is great. I hope committee will want to do that.

On page 19 of your testimony,[1] Mr. Grace, you referred to the disengagement from the commercial generation of electric power and privatization. You are really talking about selling these PMA's?

Mr. **Grace**. Yes, we are, sir.

Senator **Armstrong**. I thought that was what that meant, but I wanted to be absolutely sure. You are talking about selling the TVA.

Mr. **Grace**. Yes, sir.

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[1] See p. 39.

Senator **Armstrong**. You are talking about selling Bonneville Power Authority?

Mr. **Grace**. Yes, sir. We are talking about taking that money in. In other words, reflecting the estimated proceeds from sale of the PMA's.

Senator **Chiles**. Who would buy them? [Laughter.]

Senator **Armstrong**. I would like to ask you to take a look with me at page 21.[1] I do not want to be argumentative. In fact, I am probably more enthusiastic about your report than any member of this committee, and I say that thinking that most of my colleagues are relatively enthusiastic.

Mr. **Grace**. Including Senator Metzenbaum?

Senator **Armstrong**. Including Senator Metzenbaum, especially Senator Metzenbaum. That is really right. In fact, some of the issues that you raise in here are issues that Senator Metzenbaum and I went to call on the Secretary of Defense about 3 years ago. As a matter of fact, some action has been taken as a result of our visit.

Senator **Metzenbaum**. As a matter of fact, we did a whole hour TV show on some of those very same issues.

Senator **Armstrong**. That is exactly right. Let me ask you, though, despite my enthusiasm for the work you have done, let me ask you to take a look at the last paragraph on page 21. I am wondering if that is not an exaggerated observation.

The conclusion that I would draw from looking at that is that the reason for this escalation, twentyfold increase in 20 years, is simply because no one was paying attention. Is that really a fair statement?

Mr. **Grace**. No; I mean, in other words, the impact of no one, quote-unquote, watching the store on health care is readily apparent, I think that is an overstatement. In other words, that had an impact on it but it was not the cause of it going from $3 billion to $71 billion, but it probably would have gone from $3 billion to about $55 billion.

VETERANS' ADMINISTRATION SUPPORTIVE OF RECOMMENDATIONS

Senator **Armstrong**. Is it true that the Veterans' Administration took a look at your recommendations and just said basically forget it.

Mr. **Grace**. Well, the Veterans' Administration itself? I do not think so.

Senator **Armstrong**. I understand the director of the Veterans' Administration rejected all of your suggestions out of hand. Am I mistaken about that?

Mr. **Larkin**. I do not think we know. I do not think he has communicated that to us.

Mr. **Bolduc**. I have personally met with Mr. Walters, and we have had a meeting. We had a meeting last week at the White House to go over the recommendations, and such is not the case.

Senator **Armstrong**. He has not rejected these?

Mr. **Bolduc**. He has not.

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[1] See p. 41.

Mr. **Grace**. Has not. I attended part of the meeting, too, Senator. In the White House on Friday it was.

Mr. **Bolduc**. He is very supportive.

Senator **Armstrong**. OK. I appreciate that.

On page 26,[1] gentlemen, when we say that the use of electronic funds transfer could save $294 million in alcohol and cigarette tax collections, are we talking about when we say, "saved" do we really mean simply speed up the collections?

Mr. **Grace**. Yes.

Senator **Armstrong**. I assumed that to be the case.

Mr. **Grace**. That is what you call a cash enhancement.

ENORMOUS AMOUNT COULD BE SAVED IN PENSIONS

Senator **Armstrong**. On page 27,[2] you refer to military pensions and civil service pensions, not in this statement, I believe, but in some other document I have seen a notation that an enormous amount could be saved in military pensions.

Could you just say to us in one breath what the nature of the change is that would save $7 or $8 billion in the Air Force pensions? Was that the correct number?

Mr. **Bolduc**. The projected 3-year savings is $15.05 billion over 3 years.

Mr. **Grace**. In the Air Force.

Senator **Armstrong**. I knew it was a very large number, and I have not had a chance yet to dig into the report, although I intend to do so. In fact, I intend to dig into everyone of the reports in the next month or two.

Mr. **Bolduc**. Essentially the net net of what we are recommending in both the private—let me go back a little bit. We took a look at civil service retirement as well as military retirement. We compared the various benefits that they provided against the best private sector pension programs in terms of numbers of years that you must be with that particular organization in order to be eligible for retirement, what was used in the way of base salary upon which retirement benefits are based.

For example, the private sector uses a 5-year average of the last 5 years. The military and civil service use 3 years. Up until a couple of years ago, the military used the last date of employment. Twenty-year retirement is eligible on the military side.

Senator **Armstrong**. In other words, you are saying the nature of the reform that you suggest is to make the military and civil service pension less generous, make it more comparable to the private sector.

Mr. **Grace**. Right; that is it exactly.

Mr. **Larkin**. The COLA there is one of the big things, too, Senator.

Senator **Armstrong**. Gentlemen, I think it is really important as we talk about this just to be as frank about it as we can. You are saying that the pensions are too high and they ought to be cut.

Mr. **Larkin**. That is right.

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[1] See p. 46.

[2] See p. 47.

Senator **Armstrong**. Maybe I will agree with that after I have read your report. I do not know whether I will or not. But we should not leave in anybody's mind the idea that there is some easy way out if there is not. If there is some reform of management practices or a different bookkeeping way that is going to save $15 billion, then we want to do it.

If what we are really talking about is asking Senators to vote to cut these pensions, and that is what I understand you are talking about——

Mr. **Grace**. Or to raise the retirement age or to maybe reduce the COLA, things like that. You are absolutely right, Senator.

Senator **Armstrong**. I just want to be sure we have a clear understanding.

Mr. **Grace**. Yes, sir.

Senator **Armstrong**. I just have two other questions. I could keep you guys all afternoon because I am excited about it, but we want to hear from Dr. Penner, and I apologize to him for running well behind schedule, but I do have two other questions.

REPORT WILL BE DISCUSSED WITH PRESIDENT

First, Mr. Grace, have you discussed this report or these reports with the President yet?

Mr. **Grace**. Not the reports themselves. I have discussed with him some of the overall implications for a very short time. I have not felt it was right to bother the President until we finished, and we are not going to be finished until early January.

Senator **Armstrong**. I see. But, you do expect to have an opportunity to present this information.

Mr. **Grace**. I am going to present it to him, and then I expect to meet with him after.

Senator **Armstrong**. And to discuss it with him at some length?

Mr. **Grace**. Yes; I do, Senator.

Mr. **Larkin**. You recognize, Senator, at this time, each of the agencies and departments are studying their own report and they are reporting into the White House staff as to the recommendations they are willing to accept, those they have concerns about, those they need to study further, and some perhaps that they think are impractical. That is going on.

Senator **Armstrong**. Mr. Larkin, at this very moment, those agencies are undermining your work. So I urge you to get on with it.

Mr. **Grace**. And we are undermining them, too. [Laughter.]

Senator **Armstrong**. I understand that, as well.

Mr. Grace, did you read the book, "Pursuit of Excellence?"

Mr. **Grace**. No, I never read any books. [Laughter.]

Mr. **Bolduc**. In Search of Excellence by Peters?

Senator **Armstrong**. Yes, by Peters and by somebody else. It was written by two management consultants.

Mr. **Bolduc**. Yes.

Senator **Armstrong**. What did you think of it in a couple of words?

Mr. **Bolduc**. I think it is an outstanding piece of work.

PRINCIPLES OF SUCCESSFUL COMPANIES DO NOT APPLY TO FEDERAL GOVERNMENT

Senator **Armstrong**. That seems to be the general conclusion of people who have read it. I read it and got very excited about it, and then I got a little gloomy, as I reflected on the face that of all the principles which these two outstanding authors extracted from the successful companies they studied, I could not think of one of those principles which was in general application in the Federal Government.

As a matter of fact, of every one of the hallmarks of excellence in the private sector which they mentioned, it appears to me that we brutually and systematically violate every one, and have raised our violation almost to the level of an issue of principle in the Federal service.

Mr. **Grace**. I do not think it is a good book. Did it not have Texas Instruments in there as one of the well run companies? [Laughter.] Did it? I did not read it. Did it?

Mr. **Bolduc**. Yes.

Mr. **Grace**. I mean, it is a lot of baloney, I think, Senator. [Laughter.]

Senator **Armstrong**. Mr. Grace, I urge you to read the book, and we thank you very much. I will tell you what. I am going to read your book which I understand is this big.

Mr. **Grace**. It is.

Senator **Armstrong**. "In Pursuit of Excellence" is about that big, and it is worth reading.

Gentlemen, thank you very much for coming and for your testimony this morning.

Senator **Metzenbaum**. Mr. Chairman, do we have a second round? Are we in that second round? I think it would be——

Senator **Armstrong**. Before you proceed, let me explain the problem. We are now 55 minutes behind schedule.

Senator **Metzenbaum**. I understand.

Senator **Armstrong**. And Dr. Penner has been gracious enough to agree that he could be delayed, but I am not eager to delay him much longer, if you do not mind.

Senator **Metzenbaum**. I understand that, but I think it would be inappropriate if we did not at least raise some questions with Mr. Grace about his emphasis on cutting food stamps, and I would like to have about 5 to 7 minutes.

Senator **Armstrong**. I am reluctant to cut that off, Howard, but I honestly feel that we need to give Dr. Penner his time.

Senator **Metzenbaum**. Dr. Penner is available to us on a regular basis, whereas Mr. Grace, it is a privilege to have him here.

Mr. **Grace**. You will have a lot of those privileges if you want to because this is big-league stuff for me. I am thrilled. [Laughter.]

Senator **Armstrong**. I am reluctant to cut it off. Do it as quickly as you can, if you do not mind, just out of consideration for Dr. Penner.

Senator **Metzenbaum**. I will. I appreciate it, and I do not want to be rude to Dr. Penner.

HUNGER A PROBLEM FOR MANY

Mr. Grace, let me say that some of the things you talk about are great, but some of them, I think you are a little off base, like when you say on food stamps:

> Let us put it this way. I mean, you get something for nothing, you know, and anybody who is getting something for nothing is going to scream like hell if anybody even tampers with that. If anybody even talks about it, they are saying to take food out of the mouth of starving people. So they have the propaganda bit damn well organized.

Now, frankly, Mr. Grace, I think that the issue of food stamps is not just propaganda. I think it is a problem for people in this country and I am not sure I know that many of them, and I am sure you know that many of them.

But you should know that food stamp and child nutrition outlays for fiscal 1982 through fiscal 1985 were slashed already by over $12 billion or 17 percent by this administration according to CBO and that according to the Department of Agriculture, changes achieved by the administration in the food stamp program and child nutrition programs have resulted in the termination of 800,000 people from the food stamp program, 300,000 students from the school lunch program, and 500,000 students from the school breakfast program.

As a matter of fact, throughout the Nation, Philadelphia paper, Living on One Meal a Day or Nothing; Richmond Times, Even Soup Kitchens Feel Federal Cuts; Cleveland Plain Dealer, Needy Brave Cold and Long Lines for Free Cheese; Boston Globe, U.S. Hungry Cueing Up 1930's Style, et cetera. I have a host more.

If you recommend an additional $6.5 billion cut in food stamps by reducing basic benefit levels, subtracting school lunch and child nutrition payments from food stamp benefits and eliminating the $10 minimum monthly benefit, even President Reagan has had to respond to this crisis of growing hungrier in the country by announcing a task force on August 2, 1983.

We are not talking about a fun and games issue. Hunger is not a problem for you, Mr. Grace. Fortunately it is not a problem for me and my guess is for nobody else in this room. But there are millions of Americans who find it a real problem.

I, therefore, have to ask you how can you justify coming in and urging a $6.5 billion cut in food stamps, school lunch programs, basic benefit levels, child nutrition programs——

FOOD STAMP FORMULA IS OBSOLETE

Mr. GRACE. That is over 3 years, Senator, and you know you were a Senator here in the 1970's, right?

Senator METZENBAUM. I came in 1974, right.

Mr. GRACE. Well, 2 years before you came, food stamps were $1 billion. Then they got up to $12 billion. You know perfectly well if you ever go to a supermarket you can see people in fur coats with Cadillacs using food stamps or buying beer and everything else.

There is one hell of a lot of fraud in food stamps, and you know that as well as I do.

Senator METZENBAUM. Well, Mr. Grace, there are always some violations, some egregious cases, but by and large food stamps, which provide 46 cents per person per meal, 46 cents per person per meal is the allowance on food stamps. And frankly the Republican mayor of the city of Cleveland is screaming about the problem of people being hungry, and that happens to be my home community.

And across the country, you find hunger in American cities. Here is the book put out by the U.S. Conference of Mayors. Now, these are not all flaming liberals. These are not people who are just do-gooders. These are people who deal with the problem day in and day out.

And I would just urge upon you. I cannot convince you, but I would urge upon you that you set up a special group, three people, four people, and that you send them to anyone of these cities where we have these headlines and many others across the country to really see what hunger is and to whether or not you would reassess this.

Mr. **Grace**. Well, we certainly will, Senator, and I will say this to you that I participate in food lines, St. Francis in New York, on 33d Street. I am well aware there is hunger. The whole point, we were asked to look. The formula that was adopted in the early 1970's has become obsolete with reference to the size of the families, with reference to the age breakdown of the families, et cetera.

We merely pointed out that the formula since it was adopted in the early 1970's—I think it was 1971—has become obsolete. We are not trying to take food away from anybody. We are pointing out—I was hit very hard when I made a comment on Puerto Rican food stamps originally. It had gone to $1.2 billion, and there are only about 3 million people.

Now, that has since been cut and they have a new system in Puerto Rico, to $800 million. They saved $400 million, and the Governor of Puerto Rico feels that it is more effective than it ever was.

There were three people in Puerto Rico, as you know, who got away with something like $100 million.

Mr. **Bolduc**. It was a million a month as I recall it.

Mr. **Grace**. No, it was over $100 million these people got away with. Anyway, in Puerto Rico now they are sending $400 million less, and they say that they are doing a better job.

IMPACT OF BUDGET CUTS

Senator **Metzenbaum**. Well, the Chairman has asked me to be brief, and I wanted to raise the issue with you. I am concerned about it. I really think your Commission is off base on this subject, and I have before me, Mr. Chairman, a report from the Center on Budget and Policy Priorities here in Washington. I am not asking for the entire matter to be put into the record, but I would like to ask that the six points that they made as to what the impact of these budget cuts would have upon the poor be included in the record at this point.

Senator **Armstrong**. Does this address itself to the impact of the cuts recommended by the Grace Commission?

Senator **Metzenbaum**. Yes. It says, the first one, "Among those hardest hit would be the elderly and disabled. Virtually every elderly and disabled household on the program would have its benefits cuts."

Senator **Armstrong**. These are addressed directly to the Grace Commission report.

Senator **Metzenbaum**. Yes. The report is "Impacts of Recommendations of the President's Private Sector Survey on Cost Control for Changes in the Food Stamp Program."

Senator **Armstrong**. Is that the document you have in your hand?

Senator **Metzenbaum**. Yes, it is.

Senator **Armstrong**. Without objection, it will be entered into the record. And Mr. Grace, if you would be kind enough to ask your staff to furnish us any counter response we will include that in the record also.

[The following was received for the record:]

CENTER ON BUDGET AND POLICY PRIORITIES

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Robert Greenstein
Director

IMPACTS OF RECOMMENDATIONS OF THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL for CHANGES IN THE FOOD STAMP PROGRAM

This week the President's Private Sector Survey on Cost Control, a panel of 163 businessmen headed by J. Peter Grace, issued a series of draft reports recommending changes in many federal programs. Grace stated at a news conference: "Our principal goal has been the improvement of systems and management procedures."

One of the programs targeted for the deepest reductions was the food stamp program. Virtually all of the very deep reductions in the food stamp program would be achieved through large benefit reductions affecting nearly every food stamp household.

The food stamp recommendations were included in a report proposed by the panel's Agriculture Department task force. The recommendations will be formerly considered by the panel's Executive Committee on April 15.

Benefit Reductions

- The Survey recommendations include $6.7 billion in new food stamp benefit cuts over the next three years.
- These cuts would be on top of the $6 billion in food stamp cuts for the next three years that have already been enacted (during the Reagan Administration).* In effect, the new recommendations would more than double the size of the cuts.
- Despite the supposed emphasis on achieving savings through improved management procedures, the panel's recommendations include procedures that would save only $30 million in food stamp administrative costs. 99.6% of the Survey's recommendations for savings in the food stamp program would come from reducing benefits for low income households.

The Impact on Food Stamp Households

An examination of data on the characteristics of food stamp households, issued last year by the U.S. Department of Agriculture, shows that the Survey proposals would have dramatic impacts:

- Over 96% of all food stamp households -- including the poorest households on the program -- would lose benefits. (Only households of seven or more households would escape benefit cuts, with some of these households receiving small gains in benefits.)

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*Estimates of food stamp cuts enacted in 1981 and 1982 from the Congressional Budget Office.

- More than 7 million households -- with more than 18 million persons -- would suffer benefit losses. In most cases, the benefit cuts would be substantial.

- Among those hardest hit would be the elderly and disabled. Nearly all elderly and disabled households on the program would have their benefits cut.

- Between one-fourth and one-third of all households on food stamps with one or more elderly persons (between 400,000 and 500,000 elderly households) would be terminated and have all their food stamps taken away. Many of these are elderly women living alone.

- Some elderly persons with incomes as low as 67% of the poverty line would be terminated.

- Most remaining elderly households would lose between $132 and $192 in stamps each year.

- The average food stamp household consists of about 3 persons. Under the Survey's proposals, all 3-person households, including the poorest, would lose at least $240 a year in food stamps.

- A large number of 3-person households consist of a mother and two children. All households consisting of a parent and two school children would lose $375 a year in stamps under these proposals.

November 7, 1983

ATTACHMENT A

ANALYSIS OF THE SPECIFIC PROPOSALS MADE BY THE SURVEY

1. Proposals to alter the basic food stamp benefit standard

- The Survey recommendations include two changes in the way in which basic food stamp benefits are calculated. These changes would reduce food stamp benefits for all households of 6 or fewer persons -- which comprise 96% of all food stamp households.

- Current food stamp benefits are already low. The average benefit is 46 cents per person per meal. The maximum benefit (provided only to families with no disposable income available for food) is 69 cents per person per meal.

- Nevertheless, the Survey has recommended reducing the basic benefit levels. The Survey recommendations include several devices to alter the benefit computation formulas in order to produce sweeping across-the-board benefit cuts for 96% of food stamp households. Households would be affected in the following manner.

Household size	Annual benefit change
1	- $132
2	- $192
3	- $240
4	- $192
5	- $60
6	- $120
7	+ $84
8+	+ $36

(Note: this table shows only the impact of proposals to alter the basic benefit levels. The millions of households who would be affected by the other food stamp proposals -- described below -- would lose considerably larger amounts).

2. Proposal to eliminate the food stamp minimum benefit

- Currently, one and two-person households who have sufficiently low incomes and assets to meet the food stamp eligibility standards receive a minimum benefit of $10 a month ($120 a year).

- The Survey recommends terminating benefits for those households now receiving the minimum benefit.*

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*The Survey recommended both eliminating the minimum benefit and embracing a USDA recommendation that all those qualifying for less than $10 a month be terminated.

- USDA data shows that 70% of those terminated would be elderly households. By itself, this proposal would result in 300,000 elderly households having all their benefits taken away. Many of these would be elderly women living alone.

- If this proposal and the Survey proposals to reduced basic food stamp benefit levels were all adopted, the combined effect would be to terminate benefits for about 700,000 households. Once again, the majority of these would be elderly.

- Between one-fourth and one-third of all food stamp households with elderly persons would be terminated if all the Survey proposals were adopted (about 400,000-500,000 elderly households).

- Some elderly persons living alone with incomes as low as $273 a month -- only 67% of the poverty line -- would be terminated. In some states, most SSI recipients would lose all their food stamps.

- The proposal to eliminate the food stamp minimum benefit was included in the Reagan Administration budget last year and was rejected on a bi-partisan basis.

3. Reducing food stamp benefits for families with children receiving school lunches or participating in other child nutrition programs

   - The Survey has also called for cutting food stamp benefits for families with children receiving school lunches.

   - The Survey's proposal is similar to that proposed by the Reagan Administration. The Reagan proposal would have cut a family's food stamp benefits by about $10-$11 a month for every child in the family eligible for free school lunches. The Survey proposal would cut benefits about $7.50 a month for every child eligible for free school lunches.

   - The Administration's proposal was defeated 14-3 in the Senate Agriculture Committee, with a solid majority of both Republicans and Democrats opposing it.

   - The proposal was rejected because it would take food away from many of the poorest families in the country. Analysis done by the Reagan Administration's own appointees in USDA showed that 43% of all food stamp households with gross incomes below 50% of the poverty line -- the poorest of the poor -- would lose benefits under this proposal. These same figures apply to the Survey's proposal as well.

Mr. **Bolduc**. I would be more than happy to address some of the issues that the Senator brings up very quickly.

Senator **Armstrong**. Let me urge that we cut it off here. We are now well beyond our scheduled time, and I would be glad to pursue this another time. Senator Metzenbaum, I would encourage you also to read the General Accounting Office report on this matter which indicates that the level of simple error in the program exceeds 10 percent, and in some States, it is as much as 16 percent.

Mr. **Grace**. That is right.

Senator **Armstrong**. But this is something that needs more extended discussion than we have time for now. Again, my thanks to Mr. Grace, Mr. Larkin, Mr. Bolduc, and Mr. Gish. We are grateful not only for your presence here this morning but for the work that has lead to this meeting.

Thank you very much.

Mr. **Grace**. Thank you.

Senator **Armstrong**. Dr. Penner, please come forward.

We are glad to welcome Dr. Penner in his first appearance before the committee since his assumption of his responsibilities as Director of the CBO.

I expect and hope that this will be the first of many opportunities that we will have to be together and we are looking forward not only to what you may have for us today but in the future as well.

Senator **Metzenbaum**. Dr. Penner, I just want to say to you that I am interested in what you have to say, and if I leave early, it is not from a lack of interest. It is because of a luncheon date, and I do not want to be insulting.

Dr. **Penner**. No problem, Senator Metzenbaum.

Senator **Armstrong**. Dr. Penner, you may proceed with your statement.

STATEMENT OF RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. **Penner**. Thank you very much, Mr. Chairman. I am pleased to appear here today to discuss the relationship of the preliminary Grace Commission recommendations to the ongoing work of the committee and of CBO in dealing with the structural deficit problem.

In my complete statement,[1] which I will summarize with your permission, I cover three topics. First, the scope and nature of the Grace Commission's proposals. Second, how CBO is making use of the Grace Commission's work in our analysis of budget options. And third, general considerations in the use of budget-reduction lists.

Giving an overview of the Commission's work is difficult because of its monumental nature. The dollar values of the various Commission recommendations run from a saving of several billions of dollars for retirement system reforms to a $1 million saving for monitoring telephone usage in the Department of Labor to reduce unauthorized phone calls.

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[1] See p. 89.

Some of the Commission's suggestions would produce long-term budget reductions, but other savings might be quite short-lived. In short, the 1,300 members of the Commission's task forces have left very few stones unturned.

If you do not mind, I will skip over the part of the statement that relates the Commission's work to ours at CBO, and go on to general considerations in using lists of this type.

The committee should keep in mind three general considerations when using any list of budget-reduction ideas. First, although deficit reduction must receive high priority, all changes achieving substantial savings also impose costs.

Second, estimating the precise year-by-year savings that would result from any policy change is difficult.

Third, some types of savings have historically proved difficult to obtain.

ASSESSING COSTS AND BENEFITS OF GRACE REPORT

Even at this early stage of our review of the Grace Commission budget-cutting proposals, it is obvious that almost all involve difficult tradeoffs that cannot be resolved without making value judgments.

As is usual, progress in reducing the deficit is not painless. Specific individuals, institutions, and regions are going to be hurt. Some recommendations explicitly cut out or reduce a program's benefits; an example is the Commission's proposal to reduce food stamp benefits. But even those that are directed mainly toward efficiency would impose costs on someone. Let me give two examples.

Port user tonnage fees. The Commission recommends levying a port user tonnage fee to cover the $500 million annual operating costs of deep-draft harbor dredging by the Corps of Engineers. If the fee were uniform, users of low-cost ports would subsidize users of high-cost ports. But if the charge at each port reflected its actual dredging costs, high-cost ports would lose traffic to low-cost ports. In either case, port users would pay more than under the present system, and there would probably be a shift of economic activity among regions.

Revised selection criteria for IRS audits. The Commission proposal would almost surely raise Federal revenues and improve taxpayer compliance, but it would be almost equally sure to impose added audit costs not only on cheaters but on some taxpayers in full compliance. These costs, though outside the budget, should not be ignored.

Indeed, many of the Commission recommendations have appeared before in the President's budget or in CBO annual deficit-reduction volumes. Because of their distributional or other effects, the Congress has not seen fit to implement them.

Now, let me stress that just because subtractions from the budget deficit may hurt someone does not mean that they are not worth doing. Benefits must always be assessed against costs.

Similarly, the fact that proposals have been considered in the past and rejected implicitly or explicitly does not mean that they should not be considered again. The Congress faces an extraordinarily difficult deficit problem. If there were painless solutions, the problem would have been solved long ago. The Grace Commission does not claim to have found easy solutions, and it has not.

SAVINGS ESTIMATES

The Grace Commission is now using an estimate of $341 billion for the savings. You just heard Mr. Grace say that would be lowered to $302 billion if you remove duplication. In any case, even with that latter number, one must not jump to the conclusion that more than $100 billion could be saved on average in each of the 3 years, 1985, 1986, and 1987.

As the Commission report clearly points out, the total savings estimate—that is, the $341 billion—includes much duplication, is based on an assumed inflation rate far higher than used in CBO projections, and involves some recommendations that could not be fully implemented in the 1985–87 timeframe.

The Grace Commission volumes themselves provide a long detailed warning about these matters, which appears on pages 7 and 8 of my complete testimony.[1]

Let me illustrate what some of those caveats mean for those who wish to translate the Grace Commission proposals into budget recommendations. The 10-percent inflation and interest rate assumption is well above the rates that CBO currently projects.

For example, we project the inflation rate to be under 5 percent for the next 3 years. Savings from procurement reduction, program eliminations, or reductions in eligibility for transfer payments will be overstated if based on a higher rate of inflation.

The fact that the 3-year period referred to in the Grace Commission reports is not always the same 3 years means that one cannot simply add up the savings from various proposals and apply them to the next few years. For example, the Commission recommendation to relax Davis-Bacon requirements would not significantly affect outlays until spending from past commitments was replaced by post-reform contracts. Similarly, military retirement changes recommended would not begin to reduce Government outlays substantially for 8 years, because benefits for senior personnel now on active duty would not be changed.

The preface of the Grace Commission report cautions that the various task force reports may contain several duplications, as we have already heard, but there are several other sources of overstatement.

One lies in the interaction of different programs. For example, the savings from streamlining the disability insurance appeals process, as recommended by the Commission, would be partially offset by increased food stamp benefits for which many applicants denied disability insurance would then become eligible.

Another factor that needs scrutiny is the representativeness of the time period over which savings are measured. For example, certain kinds of cash-management savings, in which the Government slows down the rate at which it pays or speeds up the rate at which it collects, may save large amounts in the first few years as payments are slowed, but much less in future years as the delayed payments are finally made.

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[1] See pp. 95 and 96.

Slowing progress payments on military contracts, which the Grace Commission estimates would save $9.4 billion over the first 3 years but only a little more than $1 billion a year thereafter, is a good example of how short-run savings may not be an accurate indicator of long-run savings.

SPEED OF IMPLEMENTATION

One additional lesson from budget history is worth noting here. History shows that Government programs rarely go up as fast as their proponents wish, and the same inertia can be expected to hold back the pace of reductions as well.

Specifically, many programs are locked in by contracts already drawn or by commitments already made. In other cases, the Congress will see fit to phase in changes or to grandfather or hold harmless certain recipients.

The upshot of all of these considerations is that one cannot expect to realize every dollar of the savings estimate in the Grace Commission report. Indeed, based on the few cases we have had a chance to investigate, the savings potentials of a number of Grace Commission recommendations may be only a small fraction of the amount stated.

I am concerned that the broad publicity given to what may be a considerably inflated estimate will create false hopes now and disappointments later when the numbers are refined.

Nevertheless, the reports make an extremely important contribution. They contain a number of good ideas and the Commission is to be congratulated for its effort.

In conclusion, as the Congress considers options for dealing with today's troublesome budget deficit, suggestions from all sources covering a range of possible actions should be considered. The Grace Commission is certainly one important new source of deficit reduction ideas.

Nonetheless, in using the Commission's work, the Congress should be aware that most proposals that would achieve appreciable budget savings would adversely affect some current beneficiaries of present Federal policies, that the year-by-year savings from some actions may be difficult to estimate, and that some types of savings may be especially difficult to achieve.

Finally, if we are to do justice to the Grace Commission proposals in the context of the congressional budget process, those put forward for adoption must be specified in great detail.

Detailed specification is necessary if CBO is to produce independent estimates of budget savings. Even then, some savings, such as those from the management initiatives in the Grace Commission reports, will be difficult to assess accurately. Also, past experience indicates that vaguely described management savings have not come to fruition, and relying on them has only reduced the credibility of the budget process.

Let me close by again commending the Grace Commission. An enormous amount of personal effort, much of it provided on a volunteer basis, went into its task. The job was, indeed, formidable, and I look forward to the final report.

Thank you, Mr. Chairman.

Senator ARMSTRONG. Thank you, Dr. Penner.

[The prepared statement of Dr. Penner follows:]

PREPARED STATEMENT OF RUDOLPH G. PENNER, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Mr. Chairman, I am pleased to appear here today to discuss the relationship of the preliminary Grace Commission recommendations to the ongoing work of the Committee and of the Congressional Budget Office (CBO) in dealing with the structural deficit problem. In my statement, I will cover three topics:

- The scope and nature of the Grace Commission's proposals;
- How the CBO is making use of the Grace Commission's work in our analysis of budget options; and
- General considerations in the use of budget-reduction lists.

BACKGROUND

President Reagan established the President's Private Sector Survey on Cost Control (PPSSCC) in June 1982 under the chairmanship of J. Peter Grace. Thirty-seven task forces have produced 2,236 recommendations. According to commission documents, total "savings" and "revenue enhancements" of $341 billion (over three years) have been identified. Of this total, the commission claims that $145 billion can be attained through administrative actions within the agencies; the rest would need legislation. The final reports of the commission's task forces are now being published, and a summary final report is scheduled to be released in December.

Giving an overview of the commission's work is difficult because of its monumental nature. The dollar value of the various commission recommendations run from a saving of several billions of dollars for retirement system reforms to a $1 million saving from monitoring telephone usage in the Department of Labor to reduce unauthorized phone calls. Some of the commission's suggestions would produce long-term budget reductions, but other savings might be quite short-lived. In short, the 1,300 members of the commission's task forces left very few stones unturned.

RELATION OF THE GRACE COMMISSION TO CBO'S WORK

CBO is now in the process of preparing its fifth annual report on "Reducing the Deficit." Like the Grace Commission reports, this volume features lists of deficit-cutting options with their multiyear budget effects displayed. (Unlike the Grace Commission reports, the CBO volume presents only options, not recommendations.) In preparing our report, CBO adheres to a fairly strict methodology. First, budgetary savings are measured against a uniform and fully documented budgetary baseline. Second, the outlay savings or revenue gains are based on specific detailed proposals, very often those found in bills previously submitted to the Congress. Third, the budget proposals specify a particular assumption about dates of enactment, and the associated budget changes are consistent with those assumptions. Finally, insofar as possible, budgetary interactions are taken into account so that the budget savings are reported on a net basis and duplication is either eliminated or noted. For example, several alternatives for increasing Medicare coinsurance will be discussed and, in each case, the offsetting increases in Medicaid spending that would result will be subtracted from the estimated savings in Medicare.

In the past, the sources for our deficit-reduction options have been bills introduced in recent Congresses, suggestions from the Budget Committees and other Members, and CBO's program analyses. This year, I am adding to this list the reports of the Grace Commission. Our analysts are examining the commission's final reports as they appear and are incorporating a number of their suggestions into the options we will present in our report. Naturally, the commission's proposals are being converted into budget numbers through the method outlined above. The results of this long, laborious process will be available in early February.

In addition, a number of the Grace Commission proposals require more detailed analysis so that the Congress can choose from several definitive options. The following are three examples of studies we have under way that address proposals made by the commission:

- The Grace Commission proposed substantial changes in the military retirement system that would reduce benefits for those who retire early and so bring the system more in line with private-sector plans. At the request of the House Budget Committee, we are looking at alternative retirement options, including the commission's proposals, in light of their effects on costs and on the ability of the services to retain needed career personnel.

- The commission proposed paying physicians in Medicare according to a negotiated fee schedule rather than on the basis of "reasonable" charges. CBO is studying a broad range of options for physician reimbursement under Medicare.

- The Grace Task Force on Personnel Management found that prevalent overgrading of civilian jobs has led to excessive administrative and payroll costs. Their recommendations do not, however, explicitly recognize current statutory provisions that protect workers' salaries in the event their positions are lowered in grade. CBO is undertaking a study of the budgetary impacts of current misgrading of federal white-collar jobs and of alternative remedies that include modification of these statutory provisions.

Finally, in February, we will analyze the President's 1985 budget proposals, including those inspired by the Grace Commission.

As this demonstrates, the commission's proposals have already affected CBO's ongoing activities and will continue to do so as we approach the budget proposal stage.

Having said that, I must caution the Members of this Committee that it would be impossible for CBO to review all 2,236 recommendations and still do justice to the many other demands for our services. Aside from the workload problem, I should note that the Grace Commission estimates that about 40 percent of the savings from its recommendations would come from the management area. These recommendations—many of which get down to the subagency level—are not the kinds of program changes that CBO staff is best suited to analyze.

GENERAL CONSIDERATIONS IN USING BUDGET-REDUCTION LISTS

The Committee should keep in mind three general considerations when using any list of budget-reduction ideas—ours or that of the Grace Commission. First, although deficit reduction must receive high priority, all changes achieving substantial savings also impose costs. Second, estimating the precise year-by-year savings that would result from any policy change is difficult. Third, some types of savings have historically proven difficult to obtain.

Assessing Costs and Benefits

Even at this early stage of our review of the Grace Commission budget-cutting proposals, it is obvious that almost all involve difficult tradeoffs that cannot be resolved without making value judgments. As is usual, progress in reducing the deficit is not painless; specific individuals, institutions, and regions are going to be hurt. Some recommendations explicitly cut out or reduce a program's benefits, as does the commission's proposal to reduce food stamp benefits. But even those that are directed mainly toward efficiency would impose costs on someone. Let me give two examples:

Port User Tonnage Fee. The commission recommends levying a port user tonnage fee to cover the $500 million annual operating cost of deep-draft harbor dredging by the Corps of Engineers. If the fee was uniform, users of low-cost ports would subsidize users of high-cost ports. But if the charge at each port reflected its actual dredging costs, high-cost ports would lose traffic to low-cost ports. In either case, port users would pay more than under the present system, and there would probably be a shift of economic activity among regions.

Revise Selection Criteria for IRS Audits: This commission proposal would almost surely raise federal revenues and improve taxpayer compliance. But it would be almost equally sure to impose added audit costs not only on cheaters but also on those in full compliance. These costs, though outside the budget, should not be ignored.

Indeed, many of the commission recommendations have appeared before in the President's budget or in CBO annual deficit-reduction volumes. (For examples, see the appendix to my testimony.) Because of their distributional or other effects, the Congress has not seen fit to implement them.

Let me stress that just because subtractions from the budget deficit may hurt someone does not mean they are not worth doing. Benefits must always be assessed against costs. Similarly, the fact that proposals have been considered in the past and rejected, implicitly or explicitly, does not mean they should not be considered again. The Congress faces an extraordinarily difficult deficit problem; if there were painless solutions, the problem would have been solved long ago. The Grace Commission does not claim to have found easy solutions and it has not.

Savings Estimates

Although the Grace Commission is now using an estimate of $341 billion for the savings that would be enjoyed over three years, one must not jump to the conclusion that more than $100 billion could be saved on average in each of the three years 1985, 1986, and 1987. As the commission report clearly points out, the $341 billion estimate includes much duplication, is based on an assumed inflation rate far higher than used in CBO projections, and involves some recommendations that could not be fully implemented in the 1985-1987 time frame.

The following warning appears in each volume of the commission report:

> It is important to note that cost savings, revenue, and cash acceleration opportunities in this report may duplicate similar dollar opportunities reported in other task force reports. Thus, there may be instances of double counting of dollar opportunities between task force reports. These duplications will be netted-out in the Final Summary Report to the President. Additionally, dollar estimates in this report are based on reasonable and defensible assumptions, including standard three-year projections based on when first, second, and third year partial or full implementation will occur and not specific fiscal years. Accordingly, estimated savings or revenue opportunities are understandably of a "planning" quality and not of a "budget" quality. Therefore, the reader should guard against drawing conclusions or making dollar projections based on the disclosures contained only in this report. . . .

> The standard three-year projections of cost savings and revenues include 10% inflation in Years 2 and 3. On revenue accelerations and cash accelerations, savings are claimed on the interest avoided which is estimated at 10%. These rates reflect generally prevailing rates at the time the Task Force reports were prepared and may be adjusted, as necessary, in the Final Summary Report to the President.

Let me illustrate what some of these caveats mean for those who wish to translate the Grace Commission proposals into budget recommendations.

The 10 percent inflation and interest rate assumption is well above the rates that CBO currently projects—for example, we project the inflation rate to be under 5 percent for the next three years. Savings from procurement reductions, program eliminations, or reductions in eligibility for transfer payments will be overstated if based on a higher rate of inflation.

The fact that the three-year period referred to in the Grace Commission reports is not always the same three years means that one cannot simply add up the savings from various proposals and apply them to the next few years. For example, the commission recommendation to relax Davis-Bacon requirements would not significantly affect outlays until spending from past commitments was replaced by post-reform contracts. Similarly, military retirement changes recommended would not begin to reduce government outlays substantially for eight years because benefits for senior personnel now on active duty would not be changed.

The preface of the Grace Commission report cautions that the various task force reports may contain several duplications, so that potential savings may be significantly overstated. Several other sources of overstatement also bear mention. One lies in the interaction of different programs. For example, the savings from streamlining the Disability Insurance appeals process, as recommended by the commission, would be partially offset by increased food stamp benefits for which many applicants denied Disability Insurance would become eligible. Another factor that needs scrutiny is the representativeness of the time period over which savings are measured. For example, certain kinds of "cash management" savings (in which the government slows down the rate at which it pays or speeds up the rate at which it collects) may save large amounts in the first few years as payments are slowed, but much less in future years as the delayed payments are finally made. Slowing progress payments on military contracts, which the Grace Commission estimates would save $9.4 billion over the first three years but only a little more than a billion dollars a year thereafter, is a good example of how short-run savings may not be an accurate indicator of long-run savings.

Speed of Implementation

One additional lesson from budget history is worth noting here. History shows that government programs rarely go up as fast as their proponents wish, and the same inertia often holds back the pace of reductions as well. Specifically, many programs are locked in by contracts already drawn or by commitments already made. In other cases, the

Congress will see fit to phase in changes or to grandfather or hold harmless certain recipients. Thus, estimates of the long-run savings based on the full implementation of many proposals will overstate what is possible in the short run.

Overview of General Considerations

The upshot of all these considerations is that one cannot expect to realize every dollar of the savings estimates in the Grace Commission reports. Indeed, based on the few cases we have had a chance to investigate, the savings potential of a number of the Grace Commission recommendations may be only a small fraction of the amount stated. I am concerned that the broad publicity given to what may be considerably inflated estimates will create false hopes now and disappointments later when the numbers are refined.

Nevertheless, the reports make an extremely important contribution. They contain a number of good ideas, and the commission is to be congratulated for its effort.

CONCLUSION

In conclusion, as the Congress considers options for dealing with today's troublesome budget deficits, suggestions from all sources covering a range of possible actions should be considered. The Grace Commission is certainly one important new source of deficit-reduction ideas. Nonetheless, in using the commission's work—as in using any budget-reduction list—the Congress should be aware that most proposals that would achieve appreciable budget savings would adversely affect some current beneficiaries of present federal policies; that the year-by-year savings from some actions may be difficult to estimate; and that some types of savings may be especially difficult to achieve.

Finally, if we are to do justice to the Grace Commission proposals in the context of the Congressional budget process, those put forward for adoption must be specified in great detail. Detailed specification is necessary if CBO is to produce independent estimates of budget savings. Even then some savings—such as those from the management initiatives in the Grace Commission reports—will be difficult to assess accurately. Also, past experience indicates that vaguely described "management savings" have not come to fruition, and relying on these has only reduced the credibility of the budget process.

Let me close by again commending the Grace Commission. An enormous amount of personal effort—much of it provided on a volunteer basis—went into its task. The job was indeed formidable, and I look forward to the final report.

APPENDIX: ILLUSTRATIVE GRACE COMMISSION ITEMS

Included in Past CBO Deficit-Reduction Reports [1]

Limit use of tax-exempt bonds to finance hospital capital projects.

Change the definition of "prevailing wage" under the Davis-Bacon Act and limit coverage of the act.

Limit physician reimbursement under Medicare.

Eliminate dual pay for reservists who are federal employees.

Reform military retirement.

Increase collections from Power Marketing Administration.

Included in Past Administration Budgets [1]

Eliminate the $10 minimum benefit in the Food Stamp program.

Consolidate selected postsecondary student grant programs.

Consolidate the administrative expenses of AFDC, Food Stamps, and Medicaid into a block grant to states.

Implement a system for providing operating subsidies for public housing projects based on market rents in privately owned units.

Foster defense management initiatives.

Increase sanctions on states for payment errors in the Aid to Families with Dependent Children program.

Not Included Either in Past CBO Reports Or in the Administration's 1984 Budget

Consolidate the National Direct Student Loan and Guaranteed Student Loan programs.

Lower the benefit base used in the Food Stamp program.

Collect interest on erroneous overpayments to Social Security recipients.

Base federal civil service pay scales on local area wage rates.

Deposit seized cash awaiting disposition in an interest-bearing account.

End federal operation of low-volume air traffic control towers.

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1. Items do not necessarily appear in the same form in both places.

Senator **Armstrong**. Senator Chiles.

Senator **Chiles**. I have no questions, Mr. Chairman.

DEFINITION OF "STRUCTURAL DEFICIT"

Senator **Armstrong**. Dr. Penner, I suppose that all of the members of the Budget Committee are very familiar with the term "structural deficit." Just on the off chance that somebody who might read the report of this deliberation, if anybody ever does, who might not be familiar with that term, would you just discuss what you mean by the term "structural deficit?"

Dr. **Penner**. It is not one of my favorite terms, Senator, but I am afraid we are stuck with it.

Senator **Armstrong**. It is not one of mine either. That was why I was surprised to hear you use it.

Dr. **Penner**. Essentially, what it refers to is the fact that even if in some magical way we were to get to a very high level of employment by historical standards, a large deficit would remain. Indeed, worse than that, if we were to continue at that high level of employment, meaning a 6 percent unemployment rate, that deficit would grow over time, given current law.

Senator **Armstrong**. Well, this is not the moment to illuminate that issue too fully, but it is my recollection that this concept, although not this term, came into vogue first, as a result of Mr. Nixon's stewardship of National Government, and it seems to me that he rationalized some budget deficit he had one year by saying, "Well, we would not have this problem if we had full employment." So he came up with that, I think, was then termed the full-employment budget. And you have not emphasized the structural deficit aspect of our problem, but I just want to urge my colleagues to use this concept with the utmost caution, because it implies that there is some unemployment number which is normal and that this number, whatever it is, is much lower than what we are now seeing, and I am not so sure that is true.

I have a hunch that the idea of a 4-percent unemployment being normal, or 5-percent, or 6-percent. It may be quite elusive, indeed, and you did not say any of this, Dr. Penner. You just precipitated my bringing the issue into focus.

We ought to be very cautious about making any budgetary plans based upon any assumption of returning to some historical level particularly of 4 or 5 or 6 percent, because it may not happen anytime within the foreseeable future due to the changing nature of the work force.

INDEPENDENT EVALUATION OF COMMISSION RECOMMENDATIONS

Dr. Penner, you have mentioned the need, on page 11 of your statement,[1] to have an independent evaluation of the Grace Commission recommendations. I really think that is essential, because having that on the CBO option list, that is, having the various recommendations on the CBO option list is obviously the prelude to serious consideration by this committee.

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[1] See p. 99.

Will it be your intention to include these recommendations on your option list and to give us that kind of independent evaluation?

Dr. **PENNER**. Well, sir, it is impractical for CBO to analyze a list of more than 2,200 recommendations. We feel a bit outnumbered in this regard since the Grace Commission spent over $70 million developing and analyzing the list. That would keep us going for more than 4½ years.

But we are working with the committee staff at this moment to isolate the relatively few, somewhere between 100 and 200, recommendations that are really responsible for the vast bulk of the savings of the Grace Commission. We will then be looking at those fairly carefully.

Now, I should add that we are looking at the proposals that involve some sort of legislative action. Some 40 percent of the Grace Commission recommendations are called pure by management savings. I think there is some problem, by the way, with just how you define that term.

But in any case, when it comes to purely management considerations, I think groups other than CBO have an advantage at looking at those, and we, together with the committee staff, are discussing that with GAO as well.

GAO BETTER ABLE TO EVALUATE MANAGEMENT SAVINGS

Senator **ARMSTRONG**. You mean that the GAO is better able to evaluate management savings?

Dr. **PENNER**. I think on purely management issues, yes. They have a lot more experience at that than we do.

Senator **ARMSTRONG**. Here is the only hitch in that. I do not want to disagree with your professional judgment on that, and I do not disagree with it. I do not have any opinion about it, but if the so-called management savings do not appear in the CBO option list, then they really never get before us in the form that is most useful for members of this committee.

Will it be your thought to obtain those from GAO or from some other source and report them in your list or how do we ever get them cranked into the system?

Dr. **PENNER**. What we are talking about here, Senator, is really a practical management problem from our point of view. We will continue talking to the committee staff and will try to work out an arrangement where we can do that analysis in the best way possible for you all.

Senator **ARMSTRONG**. I appreciate that. Let me, however, say, and I was going to call you and say this anyway, that while, of course, the staff has got to work it out with you, keep me in the loop personally on that, will you? I think this is absolutely critical that the major recommendations get before us in some way.

I may not be for a single one of them or I may be for every one of them, but certainly if 40 percent of them involve management savings, and those have got to be evaluated by some other source and for any reason do not get into your option list, it would really be a great handicap to the committee in its work.

Dr. **PENNER**. Yes, sir. To give you an example of the situation, I have before me their status report, dated October. Now, some of this may have changed, but they list the options, I believe, in the order of the amount of savings. By the time they get to option No. 116, they are down to $8 million.

Senator **Armstrong**. I understand that, and I concur that the thing to do is to do high-quality analysis of the biggest ones rather than trying to do a slipshod job on 2,000. But I must insist that we need to have before us the ones that are not legislative in nature that also bear on the administration.

Dr. **Penner**. [Nodding head.]

Senator **Armstrong**. The record should indicate that you are nodding your head, and I take it to mean that one way or other it is going to be in the option list.

Dr. **Penner**. Somehow or another we will try and suit your needs here.

SOME TYPES OF SAVINGS DIFFICULT TO OBTAIN

Senator **Armstrong**. I appreciate that.

On page 5 your statement,[1] you say that some types of savings have proven historically difficult to obtain. I have some idea what you have in mind but would you like to elaborate on that a little?

Dr. **Penner**. There are a great number of different ways of going about that. Of course, many of the proposals of the Grace Commission, as you pointed out in your dialog with Mr. Grace, involve political policy judgments based on one's values. There have been a number of suggestions in the past for changes in, say, food stamps or veterans' benefits, that the Congress has decided for distributional reasons of one kind or another not to follow.

It does not mean that such changes should not be considered. They certainly should be. But that just has not happened in the past.

Senator **Armstrong**. In other words, you are referring in that instance, at least, to changes which would not be difficult to obtain if enacted but in which case the political problem of enactment may be substantial?

Dr. **Penner**. That is right.

Senator **Armstrong**. So it is not a technical issue in that case?

Dr. **Penner**. In the cases I just mentioned, it is not. There are also cases in between, where the Congress decides that it will make some change that does, indeed, involve a policy value judgment but where it wants to phase it in over time so that people who have relied on a certain set of programs do not get hit with heavy capital gains or losses. The Congress often does that in tax law and pension laws and other things of that nature.

Then there are cases where you might think that something is a good management idea, but for one reason or another it does not work out and does not produce a lot of savings.

Senator **Armstrong**. I will vouch for that.

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[1] See p. 93.

ESTIMATES MIGHT CREATE FALSE HOPES

On page 10 of your statement,[1] Dr. Penner, you refer, in the middle of the page, to estimates that might create false hopes and disappointments later. In fact, let me see if I can quote that directly.

"Indeed, based on the few cases we have had a chance to investigate, the savings potential of a number of the Grace Commission recommendations may only be a small fraction of the amount stated."

Tick off a couple of that ilk, would you?

Dr. **Penner**. Well, nearly $16 billion of the Grace Commission savings derive from reductions in civil service retirement benefits in one way or another. We think that to obtain that much you would have to change everybody who is already retired to some new sort of system, which would involve very large cuts for them.

To give you an idea, if you were to eliminate all COLA's, all you would save in the 1985 through 1987 period would be $4.5 billion or about 30 percent of what the Commission estimates. It would be an extreme act, obviously, to eliminate all COLA's for civil service retirees.

Another example, Grace recommends slowing progress payments on DOD contracts. This I mentioned in my formal testimony. They estimated savings of $9.4 billion. That would be in the first 3 years, and the savings would be only $1 to $2 billion a year thereafter. Perhaps more important, the Government could only save that money if somehow or another the companies producing the weapons would absorb the interest costs.

Now, there are a lot of studies that say that defense profits are not out of line with profits in the rest of industry. What you are really talking about here is whether the Government borrows some money for a while or whether the private firms borrow some money for a while. If you impose that borrowing cost on the private people, almost 100 percent of it is going to be passed back to the Government as higher product costs.

Another example: The Grace Commission would like to stabilize buys of weapons and go more to multiyear procurement. They estimate that $7.2 billion would be saved in 3 years by doing that.

They reach that figure on the basis of a judgment that it would cut procurement costs by 5 to 10 percent. A DOD estimate said that multiyear procurement for the B-1B bomber would save about 4 percent. But more importantly, the DOD has been trying to get the Congress to go much more for multiyear procurement. Indeed, they have submitted 34 requests regarding this. The Congress has only approved 17, presumably because the Congress simply does not want to commit itself to very large buys over the long run. They want to be able to change their mind on some of these things. So what you are talking about here is trading off some cost savings on the weapons system for more flexibility.

Another example. Under its preferred option for military retirement, the Grace Commission says savings would be $6.4 billion. But that would not begin under their scheme until the 1990's, so it would be very misleading to think of any of that accruing in the first 3 years. I could go on.

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[1] See p. 98.

GOVERNMENT RETIREMENT MORE GENEROUS

Senator **Armstrong**. Dr. Penner, when Mr. Grace appeared before the committee, I asked about some recommendations that the Commission had that was going to make a large saving in, I think, the Air Force retirement system, and while I did not give him much time to discuss the detail of it, in general what I thought I heard him say was that large reductions in the retirement system were justified on the grounds that it was far more generous than its counterparts in the private sector.

Now, without particularly dwelling on the political problem that might arise if we try to change this, would you agree in general with the characterization that it is more generous than the private sector for comparable service and so on?

Dr. **Penner**. I think I would be unwise to get into that because there is a lot of discussion and controversy about how generous Government retirement is relative to the private sector. But there is a side of the Pentagon that really wants to encourage people to retire early so as to promote younger good people sooner. There is a component of retirement that perhaps should be thought of as severance pay rather than retirement, and you have to decide whether this is justified in terms of recruiting and personnel management policies.

Senator **Armstrong**. Let me ask you a broad general question. In fact, I am down to a couple of questions, and I thank you again for letting us hear you late and for staying late. I apologize to whomever it is that may have had plans to meet for lunch and what-not.

Dr. **Penner**. Should I admit I did not have any plans, Senator?

GIVE GRACE COMMISSION A-PLUS FOR EFFORT

Senator **Armstrong**. Then it worked out well. I am glad I gave you something to do over the lunch hour.

Dr. Penner, in a general sort of way, what is the quality of the work that you have seen from the Grace Commission? Would you give it an A plus, an A, a B, C, D? How much reliance should member of the Senate and of this committee put on it? Should we take it with a grain of salt or a bag of salt? In other words, this is really within the area of your expertise and that of your staff. What do you think of this? Is this good stuff or is it not?

Dr. **Penner**. I certainly think you should give it A plus for effort, because it was an enormous task which they managed fairly well. When you are talking about 2,200 recommendations, however, obviously there is going to be a lot of unevenness among them.

I think the important thing is that they did, as my testimony says, leave few stones unturned. I have to confess, however, that I wish they had not totaled the savings costs the way they did; that is to say, even though they have all the footnotes in the right places qualifying their estimates, they constantly refer to about $300 billion over 3 years

Now, that number, I think, could be terribly misleading. Sometimes the 3 years is really the next 3 years. Other times the 3 years does not start until the 1990's. Other times it is a 3-year complete savings at some sort of equilibrium level that you would phase into very slowly.

So I think that the Commission has perhaps raised false expectations with regard to the amount of savings, although they themselves say in their footnotes and other places that some of the numbers lack what they call a budget quality. But that should not prevent us from looking at the ideas themselves, because many are good ideas.

Senator **Armstrong**. They are good ideas?

Dr. **Penner**. I will not vouch for every one of the 2,200 recommendations, but there are a lot of very good ideas in this report.

HOW TO COPE WITH GRACE COMMISSION REPORT

Senator **Armstrong**. My last question is this. If you were a member of the Senate Budget Committee, and particularly if you were concerned as you know that I am about getting spending back on the rail, how would you come to grips with this. If you do not mind just saying how an individual Senator or how this committee or how the Senate itself can cope with this report, what kind of a process would you suggest, evaluate and act on?

My great fear is that if there is even one good idea out of these 2,200 and my guess is there are probably lots of good ideas. I would tend to agree with what you said that while the quality may be uneven that there are probably a lot of very good ideas in here.

But the real danger is that nothing is going to happen, that after this hearing is over, which I hope will be within 1 minute or 2, that everybody will go back to sleep and in 25 years from now another Commission will be appointed and wonder why the national debt has reached the $15 trillion mark, why did not somebody back in 1983 do something.

How do we come to grips with this? How do we sharpen the questions into policy decisions and get them before the Congress in a forceful and timely manner?

Dr. **Penner**. I think there are a number of things going on here, sir, that should be helpful in that regard. First, it is a Presidential Commission, and they are reporting to the President. As I understand it, OMB is doing a fairly complete analysis of the recommendations. So you will have what OMB thinks are the good ideas turning up in the President's budget presumably. It is my information and expectation that these recommendations will be influencing those Presidential recommendations to a considerable degree.

As I have already said, we are looking at the Grace recommendations with regard to our own budget-reduction report and will be working to put a good many of them in there. We may, indeed, prepare some sort of separate report. We have not worked that out yet.

In terms of congressional activity, it is, of course, very difficult to legislate particular management savings. I can see two broad strategies here. One is institutional. I think you have to look at the organizational reforms proposed by the Grace Commission. I would look at them very critically. I am not prepared even to discuss their advantages and disadvantages, but that is one approach.

The Congress has in the past, in a move that I thought was an excellent one, appointed more inspector generals throughout the Government to look at some of these issues.

Second, you can legislate in particular areas through the appropriations process. The Congress has done this in the past in things like Government furniture procurement or Government travel. That is a bit of a blunderbuss approach. I think its effectiveness varies from case to case.

I mean, you would really prefer to have managers in the Federal Government who do not need legislation with regard to fine details like how many desks they buy or how much their staff travels, but still it is a way of reflecting your concern and interest in very particular management issues.

INCENTIVES WITHIN THE FEDERAL SERVICE

Senator **ARMSTRONG**. Did you follow the discussion of incentives within the Federal service?

Dr. **PENNER**. Yes, sir; I did.

Senator **ARMSTRONG**. I do not want to be unfair to Mr. Bolduc because I cut him off before he really got a chance to elaborate on his views. He mentioned the possibility of some kind of a bonus system, and I am generally indifferent to that. I think it is greatly overrated. In fact, I am personally convinced as one who maintains in the private sector that money is greatly overrated as an incentive, that things that I note in the private that inspire excellent performance generally are not money. There are all kinds of other things, none of which, as I mentioned earlier, are present in the Federal service.

I have been thinking about that a lot, about how we could somehow——

Dr. **PENNER**. I am not sure what sort of things you are thinking of here, Senator.

IN PURSUIT OF EXCELLENCE

Senator **ARMSTRONG**. To give you a perfect example, did you read "In Pursuit of Excellence"?

Dr. **PENNER**. I am afraid I am one who did not read it either.

Senator **ARMSTRONG**. Let me send a copy of that over to your office this afternoon, and I urge you that if you do not get anything else done this week, read that book. It is great. It is not very profound in the sense that it does not reveal anything to you that, as you read it, you will say, "Gosh, what an amazing insight." On the contrary, I think you will, as you read it, say, "What a commonplace insight."

These two authors have simply studied a number of companies which they judged to be outstanding in their field and have tried to isolate the qualities that make them successful. Now, it has been some months since I read it so I am not going to try to give you a digest of it.

They point out that such companies tend to be value driven, tend to be run by hands-on operators rather than financial manipulators. They tend to be informal. They tend to have the ability to create and disburse informal management structures.

At one point, I think one of the companies mentioned there had some 9,000 informal, in-house management structures, not staff organizations, but simply groups that would meet for coffee to decide issues, do their work, maybe meet three times and disperse.

Now, contrast that with the way the Government works, we are really not in any meaningful sense value driven in that the values of those who preside at the policy level are not, in any sense, necessarily reflected at some level in the bureaucracy. It might be or it might not be, but it is in a random sort of way.

Frequently we encounter a situation where the policymakers, whether it is the President or a cabinet secretary or the Senate Budget Committee, makes a policy which never gets off the ground precisely because those who are charged with implementing it do not agree with it. Those people who are actually the hands-on managers really never get a chance to even meet a Senator or the President or a cabinet secretary. We do not have informal management structures. We have exactly the opposite.

Well, I do not know how to relate that, and I am not necessarily—I am a businessman, but I am not one of those guys that thinks that if you ran Government like a business that it would be a good idea. I think that would be a dumb idea.

But we ought to be able to learn something from the way a good organization operates. I believe many of the principles in this book which has become a runaway best seller would apply to the university sector or to the operation of charitable organizations. The Government, I am not sure, but I do encourage you to read it, and I will send you a copy of it, which I will buy at my own expense and send it because I think it is important that you read it, I mean you more than most people in this town.

Are you enjoying your new job?

Dr. PENNER. It is pretty good so far, some days more than others.

Senator ARMSTRONG. Well, let me just tell you, based on the season of the year and the calendar and what is ahead, that within 60 days you will be back and say, "Those were the good old days." [Laughter.]

Thank you for coming and for your patience.

The hearing is adjourned.

[Whereupon, at 12:45 p.m., the committee adjourned at the call of the Chair.]

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